**AUDITING**

**BBA N 605**

**UNIT-5**

**Recent Key trends in auditing**

**INTRODUCTION**

Traditionally, audits were mainly associated with gaining information about financial systems and the financial records of a company or a business. However, recent auditing has begun to include non-financial subject areas, such as safety, security, information systems performance, and environmental concerns. With nonprofit organizations and government agencies, there has been an increasing need for performance audits, examining their success in satisfying mission objectives. As a result, there are now audit professionals who specialize in security audits, information systems audits, and environmental audits. In cost accounting, it is a process for verifying the cost of manufacturing or producing of any article, on the basis of accounts measuring the use of material, labor or other items of cost. In simple words the term, cost audit, means a systematic and accurate verification of the cost accounts and records, and checking for adherence to the cost accounting objectives.

Based on the growing demands of global organizations as well as new expectations of investors and boards in recent years, a five important trends:

1. Change the role of internal auditors and expanding the scope of the audit,

2. Assessment of the quality of operations,

3. Accountability and transparency

4. Moving to a revision on the basis of risk,

5. Upgrading infrastructure audit in accordance with technological progress

**Nature and significance of cost audit**

It is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company. In simple words the term cost audit means a systematic and accurate verification of the cost accounts and records and checking of adherence to the objectives of the cost accounting.

The **ICWAI** defines cost audit as “system of audit introduced by the government of India for the review, examination and appraisal of the cost accounting records and attendant information required to be maintained by specified industries”

As per the **section 233 B** of **Company Law 1956**, there is the provision for cost audit. Under this section, cost audit is compulsory for all the public and govt. companies which are associated with the processing and production. If there aggregate value of net worth exceeds 5 crores or total sale exceeds 20 crores, the cost audit is must.

**Objectives of Cost Audit**

* To establish the accuracy of costing data. This is done by verifying the arithmetical accuracy of cost accounting entries in the books of accounts.
* To ensure that cost accounting principles are governed by the management objectives and these are strictly adhered in preparing cost accounts.
* To ensure that cost accounts are correct and also to detect errors, frauds and wrong practice in the existing system.
* To check up the general working of the costing department of the organization and to make suggestions for improvement.
* To help the management in taking correct decisions on certain important matters i.e. to determine the actual cost of production when the goods are ready.
* To reduce the amount of detailed checking by the external auditor if effective internal cost audit system is in operation.

**Advantages of Cost Audit:**

**To The Management**

* Cost audit helps in detection of errors and frauds.
* The management gets accurate and reliable data based on which they can make day-to-day decisions like price fixation.
* It helps in cost control and cost reduction.
* It facilitates the system of standard costing and budgetary control.
* It helps the management in inter-unit / firm comparison.
* It enables the management to identify loss making propositions.

**To The Government**

* Cost audit ensures efficient functioning of the industry. This in turn, nurtures a healthy competition among the different companies and paves a path for fast progress.
* It helps in identification of sick units and enables the Government to make relevant decisions.
* It helps in fixing prices in the case of essential commodities and checking undue profiteering.
* It enables to take decisions as to granting of subsidies, incentives and protection to various industries.
* It helps to take decisions as to levies, duties and taxes.

**To the Society**

* Cost audit enables the Government to fix prices of essential commodities. This safeguards the interests of the society.
* Cost audit enables the Government to keep a check on undue profiteering by the manufacturers and avoids artificial price rise due to monopolistic tendencies.

**To the Shareholders**

* Cost audit reveals whether any of the products of the company are making losses. Thus though the company making an overall profit, a loss making line may eat up the company’s profits. This is brought to the notice of the shareholders and the management is forced to take remedial measures, thereby making optimum utilisation of resources.
* Cost audit ensures that the shareholders get a fair return on their investments.

**Disadvantages of Cost Audit:**

* Holding a Cost Audit can be expensive. This is because a company will often bring in an independent auditor who are normally charging higher price.
* A Cost Audit can be a long process which will likely involve more time. This extra time and effort can impact an employee’s day to day routine work.
* If a Cost Audit is carried out in order to find fraudulent activity it can take a long time by which time people stealing could have covered their tracks.
* Cost Audits involve a large amount of estimation and so there is the possibility that figures will be incorrect and if record keeping from the company is not good to start with then inaccuracies will be arises

**Appointing Authorities of Cost Audit:**

**A cost auditor may be appointed by:**

(i) Internal authorities i.e., by the same management to conduct cost audit as an aid to management.

(ii) By external authorities such as, by—

**Government to conduct audit on behalf of Government.**

(b) Customer to carry out cost audit on behalf of customer.

(c) Trade association or tribunal to facilitate cost audit on behalf of trade association or tribunal.

**Types of Cost Audit:**

**Following are the main types of cost audit:**

**(i) Cost Audit to Assist Management:**

The main object of this type of cost audit is to make available accurate, relevant and prompt information to management to assist it in taking important managerial decisions. The function of this audit is to ensure management the accuracy of cost accounts. In this type of audit, a cost auditor suggests ways to reduce the cost of production and to make an improvement in the cost accounting plan.

**(ii) Cost Audit on behalf of the Government:**

The Government may appoint a cost auditor to conduct cost audit where it is necessary:

(a) To do so in the opinion of the Government under section 233-B of the Companies Act, 1956;

(b) To ascertain correct cost of certain units when Government is approached for protection or financial help;

(c) To ascertain correct cost of contract given to private firms under ‘cost plus’ basis;

(d) To fix reasonable prices of certain items of production so as to prevent undue profiteering.

**(iii) Cost Audit on behalf of a Customer:**

Sometimes, cost audit may be conducted on behalf of a customer when he agrees to pay price for a certain product on “cost plus” basis. The customer in such a case gets cost accounts of the product concerned audited to establish correct cost so that he may be able to pay price on the basis of correct cost plus an agreed margin of profit.

**(iv)  Cost Audit on behalf of Trade Association:**

Sometimes, a trade association may appoint a cost auditor to conduct cost audit:

1. to ascertain comparative profitability of its members ;

2. to determine minimum price to avoid cut throat competition among its members;

3. to maintain prices at a certain level so as to prevent undue profiteering.

**(v) Cost Audit on behalf of Tribunals:**

Sometimes, Labour Tribunals may direct the audit of cost accounts to settle trade disputes for more wages, bonuses, share in profits, etc. Similarly Income-Tax Tribunals may direct the audit of cost accounts to assess correct profit for assessment purposes.

**(vi) Cost Audit under Statute:**

The Central Government may, order that certain classes of companies which are required to maintain proper records regarding materials consumed, labour and other expenses under section 209 are required to get their cost accounts audited. The aim of such type of audit is that the Government wants to ascertain the relationship of costs and prices.

**FORM OF THE COST AUDIT REPORT**

[See rule 2(c) and rule 4]

                      I/We, ................................. having been appointed as Cost Auditor(s) under Section 233B of the Companies Act, 1956 (1 of 1956) of ................................. (mention name of the company) having its registered office at .................................(mention registered office address of the company) (hereinafter referred to as the company), have examined the books of account prescribed under clause (d) of sub-section (1) of section 209 of the said Act, and other relevant records in respect of the unit .................................. (mention name and location of the unit) for the period/year ......................... (mention the financial year) relating to ............... (mention name of the product or activity) maintained by the company and report, in addition to my/our comments in para 3 relating to auditor's observations and suggestions, that -

1.(i)    I/We have/have not obtained all the information and explanations, which to the best of my/ our knowledge and belief were necessary for the purpose of this audit;

(ii) proper returns adequate for the purpose of my/our Cost Audit have/have not been received from the branches not visited  by me/us;

(iii) the said books and records give/do not give the information required by the Companies Act, 1956 in the manner so required;

(iv) the cost statements in respect of product or activity under reference as specified in the Annexures/Proformae of Schedules I, Schedule II or Schedule III of the concerned Cost Accounting Records (\*\*...........................) Rules duly audited by me/us are kept in the company.

2.       In my/our opinion, the company's cost accounting records have/have not been properly kept so as to give a true and fair view of the cost of production, cost of sales and margin of the product under reference as prescribed under the rules.

3.       Based on my/our examination of the records of the company subject to aforesaid qualifications, if any, I/We give my/our **observations and suggestions** on the following -

(a)         the adequacy or otherwise of the cost accounting system including inventory valuation in vogue in the company and suggestions for the improvement thereof. The Cost auditor shall also indicate the persistent deficiencies in the system, pointed out in earlier reports but not rectified;

(b)         the adequacy or otherwise of the budgetary control system, if any, in vogue in the company;

(c)     the scope and performance of internal audit of cost records, if any, and comment on  its adequacy or otherwise.

4.       The Cost Auditor shall suggest measures for making further improvements in the performance in respect of cost control and cost reduction.

5.       The Cost Auditor may also give his other observations and suggestions, if any, relevant to the cost audit.

         Dated  : this ---- date of -------- 200—

at ------------------   (mention name of place of signing this report)

SIGNATURE & SEAL OF THE COST AUDITOR(S)

 MEMBERSHIP NUMBER

**Tax Audit**

Section 44AB of the Income-tax Act, 1961 contains the provisions for the tax audit of an entity. As per these provisions, tax audit shall be conducted by a Chartered Accountant who ensures that the taxpayers has maintained proper books of account and complied with the provisions of the Income-tax Act.

Tax Audit conducted by a Chartered Accountant is reported to the Income-tax department in Form no. 3CA/3CB and Form no. 3CD along with the income tax return.

Tax Audit refers to the independent verification of the books of accounts of the assessee to form an opinion on the matters related to taxation compliances carried out by the assessee. While preparing the books of accounts of the business or profession for the purpose of income tax filing, the assessee has to comply with the provisions of Income-tax Act, 1961 particularly from section 28 to section 44DB

Every person who derives income by way of Business or profession and maintains books of accounts and has not opted for computation of income on presumptive basis under section 44AD, 44ADA or 44AE of the Income-tax Act, 1961 has to get tax audit done provided his income exceeds the prescribed threshold limit.The following person are required to get tax audit done in the given cases.

* A person carrying on business if the total sales/ turnover exceeds Rs. 1 crore during the previous year relevant to assessment year.
* A person carrying on profession if the Gross receipts exceeds Rs. 50 lakhs during the previous year relevant to assessment year.

Also, the person who has opted for computing profits and gains of business on presumptive basis under section 44AD earlier and 5 years have not lapsed since then but the assessee has opted out of such presumptive income  and his income exceeds the ceiling for charge ability of income tax, is also required to get tax audit done.

Further where a person has opted for presumptive scheme under section 44ADA and he claims his income lower than the deemed profits and his income exceeds the ceiling for charge ability of income tax, is also required to get tax audit done.

Tax audit is also mandatory for the assessees opting for presumptive scheme under section 44AE, 44BB and 44BBB and claiming income lower than the deemed profits.

**Objectives of Tax Audit**

* That the balances of the liabilities of the balance correspond to outstanding debts to the Public Treasury at the closing date of the fiscal year
* That the debit balances to the Public Treasury have been valued according to the Accounting Principles and the pertinent fiscal regulations.
* Evaluate that the accounts are correctly classified in the balance sheet, between assets and liabilities.
* Check that, if there are claims raised by the Public Administration that are not resolved at the closing date, they are correctly accounted for.
* Evaluate that the procedures have been carried out in accordance with good faith, ensuring that the established legal regulations have been complied with.

**Process of Tax Audit**

There are two types of tax audit procedure:

* Verification at our offices, which is done remotely
* Verification at your establishment, which is done in person

**Tax audit vs. Financial Audit**

* The differences between the fiscal and the financial audit can lead to confusion, we detail them:
* The tax audit is an independent process, while the financial audit is driven by the company itself.
* The tax audit is an objective examination of compliance with tax obligations; the financial audit focuses more on the compliance of the accounts.
* The fiscal audit focuses on the accounting results; the financial audit in the patrimony and finances of the company.
* The tax audit examines the tax situation of the company; the financial audit, the status of the accounting books.

**Types of tax audit:**

* **Mail Audit**
* **Office Audit**
* **Field Audit:**
* **Others types of tax audit**

**Management Audit**

**Management audit** may be defined as the systematic and dispassionate examination, analysis and appraisal of management’s overall performance. It takes into account both financial and non-financial factors including economic environment, their effect on the administration and goals of the business organisation.

Thus management audit signifies critical assessment of management of the enterprise from the broadest possible point of view. The thrust of this audit is, therefore, on evaluation, with appropriate analysis for improvement on contribution towards industrial development.

**Process of Management Audit:**

Such an audit may be undertaken by the management itself, or it may be carried out with the help of management consultants. In the same way, while a comprehensive management audit may be recommended, companies may even apply it independently to some specific sections or areas of the organisation. For example, production efficiency or investment appraisal may well be the subject-matter of management audit.

**Objective/Significance of Management Audit:**

**The main objectives of Management Audit are:**

(a) To ensure optimum utilization of human resources and available physical facilities.

(b) To point out deficiencies in objectives, policies, procedures and planning.

(c) To suggest improved methods of operations.

(d) To point out weak links in organizational structure and in internal control system and suggesting improvements.

(e) To help management by providing early signals of sickness, ways and means to avoid the same; and

(f) To anticipate problems and suggest remedies to solve them in time.

**Nature of Management Audit:**

The nature of Management Audit has no limitations. The areas of review depend on the objectives of the business.

**Accordingly, the nature of Management Audit may include:**

(a) The suitability, practicability and present compliance or otherwise of the organization with its designated objects and aims.

(b) The current reputation of the organization in relation to the general public and within its own particular industrial or commercial field.

(c) The rate of return on investors’ capital – whether poor, adequate or above average.

(d) Relationship of the business with its own shareholders and the investing public in general.

(e) The ratios of operating returns and the rate of return on capital projects.

(f) The relationship between management and staff within the business.

(g) The aims and effectiveness of management at its various levels such as top level, middle level and operational level.

(h) Financial policies and control relating to production, sales and distribution and in other functions of the organization.

**Weaknesses/Problems Revealed by Management Audit:**

(a) Weaknesses among the members of the Board of Directors.

(b) A lack of awareness among directors and managers of the objectives of the organization and the extent to which these are being achieved, failure to define clearly the objectives and responsibilities of individual managers.

(c) Inadequate steps taken to provide adequate finance.

(d) Lack of technical competence of managers.