THE CONCEPT OF AUDITING

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PART ONE. 01

INTRODUCTION

The term audit is derived from the Latin term '*audire*,' which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them. Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt. Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Arthasashthra by Kautilya detailed rules for accounting and auditing of public finances. In Tanzania there the so called NBAA (NATIONAL BOARD OF ACCOUTANTS AND AUDINTING) as a special board for accountants and auditors, this board provides much experiences and knowledge as well as ethical conducts.

IMPORTANT CONTENTS

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- *Characteristics of auditing*
- *Objective of auditing*
- *Fraud in auditing*
- *Internal auditing and External Auditing*
- *Different between external and internal auditing*
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Meaning of auditing

Auditing it is the process of examining evidence regarding a report, statement, information, or other assertion to determine its agreement with established criteria. Moreover, Auditing can be defined as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users” ***(American Accounting Association, 1972).***

Prof. L.R.Dicksee. "Auditing is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they relate.

Auditing is an important professional task carrying heavy responsibility and calling for commensurate skill and judgment and whilst the exercise of skill and judgment has always been necessary for the conduct of an audit ***(Taylor & Perry’s, 1976)***.

Audit is a process whereby the accounts of business entities, including limited companies, charities, trusts and professional firms are subjected to scrutiny in such detail as will enable the auditors to form an opinion as to their truth in fairness ***(Woolf, 1997)***.

Generally auditing can be termed as the systematic and independent examination of data, statement (financial statement), records, operations, and performances of an enterprise for the stated purpose. The audits usually evaluate system input, output; processing controls; backup and recovery plans; system security; and computer facilities. These audits may review existing, as well as, systems in the development phase.

FEATURES OF AUDITING

- Audit is a systematic and scientific examination of the books of accounts of a business;
- Audit is undertaken by an independent person or body of persons who are duly qualified for the job.
- Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.
- Audit is a critical review of the system of accounting and internal control.
- Audit is done with the help of vouchers, documents, information and explanations received from the authorities.

- The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.
- The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of share holders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts.

OBJECTIVES OF AUDITING

There are two main objectives of auditing. These are as follows;

Primary objective.
The primary duty (objective) of the auditor is to report to the owners whether the balance sheet gives a true and fair view of the Company's state of affairs and the profit and loss A/c gives a correct figure of profit of loss for the financial year.

Secondary objective.
This is also called the *incidental* objective as it is incidental to the satisfaction of the main objective. The incidental objectives of auditing are:

- Detection and prevention of Frauds
- Detection and prevention of Errors.

Fraud refers to intentional misrepresentation of financial information with the intention to deceive. Frauds can take place in the form of manipulation of accounts, misappropriation of cash and misappropriation of goods. It is of great importance for the auditor to detect any frauds, and prevent their recurrence. Errors refer to unintentional mistake in the financial information arising on account of ignorance of accounting principles.

Detection of material frauds and errors as an incidental objective of independent financial auditing flows from the main objective of determining whether or not the financial statements give a true and fair view

EXTERNAL AND INTERNAL AUDITING

Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization ***(Brink and Witt, 1982).*** The term internal audit has been defined as "a independent appraisal of activity" within an organization for review of operations as a basis of service to management. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls.

Internal Auditing is an independent objective assurance and consulting activity designed to add value and improve an organization's operations. Internal auditors are employed by individual companies to investigate and appraise the effectiveness of company operations. These reviews (audits) focus on the organizations major operating activities For examples are salaries and benefits, policies and procedures for cash handling, inventory and equipment, physical security

External Auditing is an independent body which resides outside of the organization which it is auditing. This focuses on the financial accounts or risks associated with finance and external auditors are appointed by the company shareholders.

External auditing is the independent examinations of the evidence from which the financial statements are derived, in order to give the reader of those statement confidence as to the truth and fairs of the state of affairs which they disclose ***(Acc, 2008).***

Auditing lends credibility to the accounting statements and accounting system. The independent auditor or CPA attests to the reliability of the statements by attaching a written opinion to them.

Differences between internal and external auditing

MODE OF OPERATION, internal auditing is a function that operates independently from other departments and reports directly to the audit committee and resides within an organization and involves the internal auditors that are company employees while, External auditing is a function that involves independent body which resides outside the organization and involves external auditors who are appointed by the company shareholders.

ROLE AND RESPONSIBILITIES, the role of internal auditing is to advise management on whether the organization has sound system of internal control to protect the organization against loss also it advise and make recommendation on internal control in corporate governance while external auditing is to provide an opinion to the share holder on whether the financial statement give a true and fair view.

SCOPE OF WORK, the internal auditing is determined by management, it cover all areas of the organization operational as well as financial and also is limited to fundamental principle and small quantity of standards so there is greater flexibility in how the work is done, while for the external auditing is mainly determined by the auditor in order to carry out his statutory duty to report financial statement.

LEGAL BASIS, external auditing its legal requirements base on the large companies, External legal required for many while internal auditing there is no legal requirements, Public companies and many public bodies while the internal auditing legal requirement based on the code on the corporate governance recommendations and it mostly based on the company's corporate governance.

APPROACH, Internal auditing based on the evaluate system of control, as it test operations of systems and make recommendations for improvement while the external auditing rely on the testing underlying transactions that form the basis of the financial statement.

Similarities of the internal auditing and external auditing

Both do a better job of focusing on management risks. In internal auditing includes expansion into operational auditing and expansion into operational auditing while in external auditing involves audit of traditional financial statements and implementation of audit risk model.

Both are generally expanded roles and are professional activities for assessment of financial statements of a company. In internal auditing is where risks and value added become more important service areas while in external auditing increase offering of specialty services.

Both observe the manner in which the company conducts business. For example the external auditing normally addresses their reports to shareholders of corporation and observe manner of appointment. Also in internal auditing observe and adhere to the Institute of Internal Auditors (institute) "code of Ethics. All in all manner or standard operating procedure shall include performance and implementation standards to guide internal audit.

Both asses the possibility of frauds or theft, both auditing process aimed to detect fraud, technical errors and errors of principle. However, it is unreasonable to expect auditors to detect all aspects of fraud, even though they exercised reasonable skill and care.

Both compare regulations and laws with the actual operation of the firm. The internal and external auditing in any company both is the means to assess the actual activities and the financial statements of the company if are in compliance with the laws and regulations. For example, a firm can create a rule that each department should collect 20% of their activities as income to be earned per a year.

The major purposes for auditing of Financial statements of companies

Business objectives, having an effective audit system is important for a company because it enables it to pursue and attain its various corporate objectives. Business processes need various forms of internal control to facilitate supervision and monitoring, prevent and detect irregular transactions, measure ongoing performance, maintain adequate business records and to promote operational productivity. Internal auditors review the design of the internal controls and informally propose improvements, and document any material irregularities to enable further investigation by management if it is warranted under the circumstances.

Risk of misstatement, auditors assesses the risk of material misstatement in a company's financial reports. Without a system of internal controls or an audit system, a company would not be able to create reliable financial reports for internal or external purposes. Thus, it would not be able to determine how to allocate its resources and would be unable to know which of its segments or product lines are profitable and which are not. Additionally, it could not manage its affairs, as it would not have the ability to tell the status of its assets and liabilities and would be rendered undependable in the marketplace due to its inability to consistently produce its goods and services in a reliable fashion. Accordingly, an audit system is crucial in preventing debilitating misstatements in a company's records and reports.

Fraud prevention, internal audit serves an important role for companies in fraud prevention. Recurring analysis of a company's operations and maintaining rigorous systems of internal controls can prevent and detect various forms of fraud and other accounting irregularities. Audit professionals assist in the design and modification of internal control systems the purpose of which includes, among other things, fraud prevention. An important part of prevention can be deterrence, and if a company is known to have an active and diligent audit system in place, by reputation alone it may prevent an employee or vendor from attempting a scheme to defraud the company.

Cost of capital. The cost of capital is important for every company, regardless of its size. Cost of capital is largely comprised of the risk associated with an investment, and if an investment has more risk, an investor will require a higher rate of return to invest. Strong audit systems can reduce various forms of risk in an enterprise, including its information risk (the risk of material misstatement in financial reporting), the risk of fraud and misappropriation of assets, as well the risk of suboptimal management due to insufficient information on its operations.

Generally auditing activity may be negatively affected by corruption to influence auditors in order to provide untruth information, no assurance of the future that means auditors cannot give assurance about the future. In other side auditing gives way of understanding all situations of an organization financial position and to know how organization resources have been used and in which way is suitable in resource uses, with the aiming to ensure corporate objectives are achieved.