Unit 6 ❒ Special Audit

Structure

6.0 Objectives

After studying this unit the student should be able to

- State the concept of Management Audit and Operational Audit and their purposes.
- Distinguish between Management Audit and Operational Audit.
- Explain the concept of Cost Audit and its benefits as well as the statutory requirements relating to that.
- Write the nature of forecast audit.
- Give ideas of limited review and other statutory requirements as per the listing agreement.

6.1 Introduction

In order to achieve the various organisational objectives effectively and efficiently the management introduces various controls, the whole of which is known as internal control. Whether or not internal control system is sufficient and adequate and is working effectively and efficiently, internal audit is made.

Management is a collective function in itself whether or not this function or activity has been working efficiently and effectively in achieving the organisational objectives that requires a specific reference to the experts in this field. Similar is the case in regard to operational part of the organisation. For verification of cost accounts and checking as regards adherence to the cost accounting plan cost audit is done. It ensures that cost statements are properly drawn up as per records and that they represent a true and fair view of the cost of production and marketing of the product under audit.

Clause 41 of listing Agreement requires that a listed company should furnish unaudited financial results on a quarterly basis which have to be subjected to a Limited Review by the auditor of a company.

All this has therefore evolved a concept of different types of audits. In this topic, thus, we should be discussing various aspects of Management Audit, Operational Audit, Cost Audit, Forecast Audit, Audit of Interim Financial Statements and Limited Review as required by listing agreement under SEBI.

6.2 Management Audit

6.2.1 Concept and Definition

Management audit deals with various aspects of the management process. It is an audit to examine, review and appraise the various actions and policies of the management on some standard basis.

The following definition may be noted :

"Management audit is a systematic, comprehensive, critical appraisal of the organisation, structure, management practice and methods conducted normally by external independent persons. Its primary objective is to motivate management to take action which will lead to increase efficiency and profitability of the organisation" (British Institute of Managament).

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Management audit is thus concerned with review and appraisal of total performance of management of the company. It is neither compulsory under any statute nor by any law but is purely voluntary and terms of reference and scope are determined by the management. This can be undertaken externally by management constultants or internally by management themselves. No specific qualification is prescribed for the management auditor. The area and scope of management audit are very wide and comprehensive and is an excellent tool of management control in various situations. It is an entirely new dimension to the audit function and has tremendous potential. It is mainly concerned with finding out the efficiency of the control system in operation. It reviews as to whether the policies laid down and decision taken were in organisation's interst and were effective. It involves a technique of assuring how effectively the management executives can plan, organise, direct and control efficiently and how effecitively they have been able to use the available resources for achieving the desired objectives.

6.2.2 Objectives

The objectives of management audit are as follows:

1. To assist all levels of management by keeping watch on all operations of the organisation.
2. To assess the management policies, their adequacy for proper performances and procedures adopted for further implementation of management policies.
3. To identify the areas which are responsible for low profitability and productivity, inefficiencies and ineffectiveness of management.
4. To recommend for improved human relation approach, new management development and overall organisational plans and objectives.
5. To assess whether the integrated management system to satisfy the obligations to the customers and society are being effectively implemented and the true and fair presentations of the results of such an examination.
6. To review the performance of the important management personnel.
7. To identify the cases and the persons responsible for the decisions resulting in heavy losses to the organisation thereby having its adverse impact on image, goodwill of the company and to take actions accordingly.

6.2.3 Need

Management audit is highly result-oriented and it can be useful in the following situations:

1. It may be conducted periodically to assess the performance of various management personnel and link a system of incentives with such an assessment.
2. Sometimes government may order a management audit with a view to assess the efficiency of the management of a company. For revivial of the company who are in various problems, goverment may ask for management audit and on getting report, government may take the following steps:
   a) Government may inject finance by granting subsidy.
   b) It may consider taking over the management.
   c) It may try to remove the constraints instead of taking the above steps.
3. A financial institution, bank may be interested in doing the management audit of a company before advancing loans or before agreeing to participate in the equity capital of an enterprise.

4. Foreign collaborators may also be interested in management audit conducted periodically as it would help them to assess the managerial abilities of their associates.

6.2.4 Steps in Management Audit

The steps taken to cover the entire scope of management audit are as under:

(i) Identification of the objectives of the organisation.

(ii) Segregation of the overall objectives of the organisation into detailed targets and plans for various segments.

(iii) Review of the organisation structure to assess whether it can achieve effectively the overall objectives.

(iv) Identification of specific responsibility centres in the organisation.

(v) Examination of the performance of each responsibility centre or functional area.

(vi) Submission of report on observations.

6.2.5 Techniques in Management Audit

The management audit requires an interdisciplinary approach since it covers review of all aspects of management function. In the process of conducting management audit, a management auditor can adopt and use a number of techniques of verificatory audit. This is primarily concerned with the appraisal of performances in the various ideas of management. In doing so, he can use the following techniques effetively:

(i) Inquiry

A management auditor may collect most of the evidence required by him by asking relevant questions and obtaining satisfactory answers to these questions.

(ii) Examination

In many cases, the management auditor conducts an examination of records and documents. It becomes necessary when the enquiry process yields certain information which needs colaboration or which suffers from internal contradictions.

(iii) Confirmation

A management auditor may also obtain written or oral statements from various persons in order to confirm the information obtained by him.

(iv) Observation of pertinent activities and conditions

In many cases, the management auditor may have to rely upon his own observation of pertient activities and conditions in the organisation. A management auditor may prepare organisational charts and flow charts as a result of his observation of pertinent activities and conditions.

(v) Correlation of information

The information collected through the various techniques has to be correlated so that proper conclusions can be drawn. The management auditor has to compare the actual performances with the standards laid down or with the performances in the previous years. A good deal of skill is required in correlating the relevant information so as to reach meaningful conclusions.

6.3 Operational Audit

6.3.1 Concept and definition

An operational audit is an organised search for ways of improving efficiency and effectiveness. In today's highly competitive business environment, the demand for operational audits can be attributed to management's desire to increase revenues, increase productivity, and reduce costs. Operational auditors search for ways to reduce waste and ineffeciency. Many corporate restructurings reported in the business process are the results of operational audits.

The Federal Financial Officer's Institute in Canada has defined Operational Audit as "a systemetic independent appraisal activity within an organisation for a review of the entire departmental operations as a service to management. The overall objective of operational auditing is to assist all levels of management in the effective discharge of their responsibilities by furnishing them with objective analysis, appraisals, recommendations and pertinent comments concerning the activities reviewed".

The American Institute of Certified Public Accountants (AICPA) defines operational auditing as "a systemetic review of an organisation's activities or a stipulated segment of them in relation to specified objectives for the purposes of assessing performances, identifying opportunities for improvement, and developing recommendations for improvement or further action".

A review of a company's computerised accounting system, assessment of its efficiency and reliability, and recommendations for improving the system would constitute an operational audit.

6.3.2 Nature and Purpose

Operational audit is primarily concerned with finding out whether all operations of the business in the areas of purchase, storage, transportation, manufacturing, quality control, marketing, financial services etc. are being carried on properly. It involves a systematic approval of the effectiveness of major functions of an organisation against corporate and industry standards and norms and theory identifying the areas where improvements can be made.

The purpose of operational audit is the following:

(1) To assure the management that operational objectives are valid and operational control information is valid and reliable.

(2) To assure that the operational activities are effective and efficient.

(3) To measure the efficiency of any operation by measuring output in relation to input is given below:

$$\text{Efficiency} = \frac{\text{Output (Effectiveness)}}{\text{Input (Economy)}}$$

6.3.3 Benefits

A properly conducted operational audit should provide management with a number of benefits, including

(i) Increased Pofitability

(ii) More efficient allocation of resources

(iii) Identification of problems at an early stage, and

(iv) Improved communications.

6.3.4 Steps in Operational Audit

Following steps should be taken in conducting an operational audit:

(i) Acquainting himself with techniques of the operations

(ii) Familiarisation with the actual operations and operating problems.

(iii) Analysis and appraisal of the control systems being followed in that area of activity.

(iv) Examination of adequacy of controls being exercised in the conduct of the activity.

(v) Recommendation to avoid defects or to remove lacunae in the operating areas.

(vi) Reporting.

6.4 Cost Audit

6.4.1 Meaning and objects

Cost audit refers to the verification of cost accounts and a list on the compliance to the cost accounting plan. It involves :

(i) The verification of the record of cost accounts like the accuracy of the cost accounts, costing techniques and cost reports.

(ii) Scrutinising these records to make sure that they adhere to the cost acounting principles and objectives.

According to the Institute of Cost and Works Accountants of India cost audit can be defined as "Verification of the correctness of cost accounts and adherence to the cost accounting principles, plans and procedures".

In our country cost audit was introduced in the year 1965, with the objective of providing complete information as to the efficiency of management and overall productivity of the factors of production.

Section 233B was incorporated in the Companies Act, 1956 by the Companies (Ammendment) Act, 1965 to provide for statutory cost audit in the case of specified companies. Cost audit is in addition to the financial audit conducted under section 224 of the Companies Act.

The main objective of cost audit is to

(i) help improve industrial efficiency all round and maximum production

(ii) make the general public cost conscious

(iii) pave the way towards its introduction in all organisations as is in advanced countries.

(iv) ensure that cost statements presents ture and fair view of the cost of productions and marketing the 'product under audit'.

It has some social objective also. They are as follows:

(i) To protect the interest of the shareholders

(ii) To produce quality goods at a reduced price

(iii) Controlling inflationary trend.

6.4.2 Importance

Cost audit is an effective tool of control in the hands of management and also is considered to be a check on behalf of the shareholders, the consumers, and the government. It identifies weaknesses in the cost accounting system and disclose inefficiences in all levels of organisation.

It is also necessary from the point of view of the consumers and the government. It helps the government in deciding whether or not tariff protection should be extended. The government may depend upon the audited cost statements to fix proper prices under a scheme of price control. Audited cost statements may be useful in keeping tax or duty based on the cost of products.

Audited cost statements may also be used by associations of various industries to setup standard costs against which individual firm may compare their actual cost figure. It plays an important role in the context of price controls and shortages in the economy. It helps in fixation of prices, assessment of tax, settling trade disputes.

6.4.3 Advantages of Cost Audit

Cost audit is immensely advantageous to the government, society, management and shareholders of the company.

A. To the Government

(i) It helps the government in fixing prices of essential commodities. It facilitates a check on undue profiteering and assessment of tax.

(ii) It helps to identify the inefficient units and take appropriate action for their survival.

(iii) It facilitates settlement of trade disputes.

(iv) It helps in bringing healthy competition amongst units in industry thereby controls inflationary trends.

B. To the Society

(i) Reasonable price increase is allowed due to increase in cost of production and thus consumers can maintain their standard of living.

(ii) Consumers are protected from exploitation. Since prices are fixedup on the basis of reliable and correct cost data the consumers are saved from any exploitation.

C. To the management

(i) It provides management reliable data for its day-to-day operations like price fixing, control, decision making, etc.

(ii) It helps to identify the inefficiencies in the working of company and thereby assists management in taking corrective action.

(iii) It facilitates management by expertise.

(iv) Control tools like standard costing and budagetory control will be facilitated.

(v) A continuous vigil on all workers can be maintained through an adequate and proper system of reporting to the management.

(vi) Inventory valuation can be done with great accuracy.

(vii) It is very much effective in detection of errors and fraud.

D. To the Shareholders

(i) It ensures shareholders a fair return on their investment.

(ii) It makes sure that proper records are kept for purchase and usage of materials and sales are not made below its cost in normal circumstances.

6.4.4 Provision Regarding Cost Audit

(a) Under Section 233B of the Companies Act, the central government may direct by an order that an audit of the cost records maintained by a company under section 209(1)(d) shall be conducted by a Cost Accountant in such manner as may be specified.

(b) Section 209 of the Companies Act, 1956 empowers the central government to make it compulsory in the case of specified classes of companies to maintain cost records.

(c) Cost audit shall be in addition to statutory financial audit conducted Under Section 224.

(d) The cost auditor shall be appointed by the Board of Directors of the company with the prior approval of the central government. The board of directors should obtain a written certificate pertaining to compliance of provisions of Section 224(1B) from the proposed cost auditor.

(e) A firm of cost accountants can be appointed as cost auditor if all the partners of the firm are practising cost accountants and the firm itself has been set up with the previous approval of central government as required by ICWA Act 1959.

(f) A person cannot be appointed as cost auditor if he attracts any of the disqualifications mentioned in sub-sections (3) and (4) of Section 226 of the Companies Act.

(i) A body corporate.

(ii) An officer or employee of the company.

(iii) A person who is a partner, or who is in the employment, or an officer or employee of the company.

(iv) A person who is indebted to the company for an amount exceeding Rs.1000 or who has given any gurantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees.

(v) A person who holds any voting shares of the company.

(vi) A person cannot be appointed if he is disqualified to be the cost auditor of its subsidiary or holding company, or another subsidiary of its holding company.

(vii) A person appointed as an auditor of a Company under section 224.

(g) The board of directors on receipt of the order from the central government passes a resolution either at a meeting or through circulation appointing a cost auditor, subject to the approval of the central government. On getting the application the central government communicates its approval to both the company and the proposed cost auditor. After that a formal letter of appointment is then issued to the cost auditor by the company.

(h) The company should provide all facilities and assistance to the person appointed as cost auditor.

(i) The cost auditor has the same powers regarding cost audit as an auditor of a company has under Sub-Section (1) of Section 227.

(j) As per Rule 6 of Cost Audit (Report) Rules, 2001 the company and all of its officers should provide all cost accounting records, statements and other required books and documents within 135 days from the end of relevant financial year.

(k) The cost auditor should submit his report to the central government (one hard copy and a soft copy) in the prescribed format and simultaneously send a copy of the report to the company within 180 days from the end of the company's financial year to which the report relates.

(l) The company has to furnish to the central government full informations and explanations on every reservations or qualification contained in the cost audit report, within 30 days from the date of receipt of the copy of the report.

(m) On receipt of further information and explanation furnished by the company, the central government may take necessary action on the report in consonance with the provisions of the law in force.

(n) The central government may direct the company to circulate the whole or such portion of the said report to its members, along with the ntoice of the AGM to be held immediately after the submission of such report.

(o) In case of non-compliance of the provisions, the company shall be liable to be punished with fine which may extend to five thousand rupees and every officer of the company who is in default, shall be liable to be punished with imprisonment for a term which may extend to three years or with fine which may extend to five thousand rupees, or with both.

(p) A cost auditor can attend and participate in the meetings of the Audit Committee constituted Under Section 292A 'in his capacity as internal auditor' without voting rights.

6.5 Forecast Audit

6.5.1 Concept and Definition

Several types of audit have been discussed earlier like financial audit, cost audit, internal audit, management audit and operational audit etc. It signifies its wide range of application in various operational fields. Therefore the term audit may be claimed to have attained multidimensional approaches. Now the time has come when the services of auditing professional is not only confined to examination of the past happenings but are expected to extend in attending the forecast of profit made by management. People are not only interested to invest money on the result of the past performance but they are also interested in the information as regards forecast of profit made by the management Thus the concept of forecast audit has emerged. Forecast audit may be defined as a critical examination and review of the forecast of profit, sales, earnings and cost of the business, made by the management for the general understanding of all those who are interested in the affairs of the business, by applying reasonable skill, care and judgement.

6.5.2 Benefits

Forecast audit has the following advantages :

1. Continuity of business can be ensured by regular check up of the different key areas of the accounting process.
2. It can strengthen the integrity of the capital structure of the business.
3. Business can go for various dynamic strategies well in advance to face the future uncertainties.
4. It helps the prospective investors to make the best investment decision.

6.5.3 Procedures of Forecast Audit

The following procedures may be followed for conducting the forecast audit :

1. Examining the nature background and environment of the business.
2. Scruitinising the different activities of the business and its products.

3. Ensuring of compliance of the generally accepted accounting principles (GAAP).

4. Verification of the assumptions upon which the profit forecast is based with reference to the economic, commericial, marketing and financial strategy of the company.

5. Verification of accounting treatment made in respect of specific items like research and development expenditure, taxation, foreign currency translation and other unusal, exceptional items.

6. Examining the procedures and methods employed for preparing the forecasts and to verify that the forecasts are based on consistent accounting policies.

7. Reviewing the materiality of important information and figures used for the forecast with reference to its reliability and authenticity.

8. Verifying the degree of accuracy of different figures that are taken into consideration for preparing the forecast.

9. Ensuring that provisions have been made properly for all contingencies.

10. Verifying the adquacy of provision for working capital and the long term finance.

11. Confirming through interview with the respective officials that all relevant post happenings and expected events likely to have effect on the business have been taken into considerations while preparing the forecast.

12. Examining the basis of sales forecast and satisfying that it is based on efficient market study.

13. Verifying the competenery of the persons involved in the preparation of forcast.

14. Examining whether the adjustments of exchange rate fluctuations are given due weight in the preparation of forecast.

15. Verifing the adequacy of electronic devices, if any, adopted for the purpose of making the forecast.

6.5.4 Problems of Forcast Audit

Following are the problems that may be faced by the auditor in the conduct of forecast audit.

Ambiguity in the clients instruction towards liability of the auditor.

2. Insufficiency of information or documents for verification.

3. Difficulty in the judgement of materiality concept relating to an item included in the profit forecast.

4. Inherent risk of audit is high.

5. Assumptions made for forecast may not be satisfactory as it varies man to man and circumstances to circusmtanes.

6. In true sense accurate forcasting are never possible.

6.5.5 Comparison between Audit of Annual Accounts and Forecast Accounts

Differences between audit of annual accounts and the audit of forecast accounts may be summarised in the following lines :

1. The auditor conducts the audit of accounts based on past happenings while in the audit of forecast accounts the auditor considers the accounts based on future events.
2. In the audit of annual accounts audit work approaches through the books of accounts but in case of forecast accounts audit work approaches through the evaluation of the administrative controls.
3. In case of annual accounts audit report is realistic where as in case of forecast accounts the audit report is to some extent unrealistic.
4. In the former case the liability of the auditor is clearly defined but in the latter it is not possible to fixup the liability of the auditor.
5. In the auditor of annual accounts the use of the phrase 'true and fair view' in the audit report justify the propriety of happenings and the risk factor is minimum. But in the audit of forecast accounts the auditor cannot certify the uncertainties as being true and fair and also it involves greater amount of risk.
6. Audit of annual accounts is done mainly based on supporting documents but no such supporting documents are available in the case of audit of forecast accounts rather the auditor has to study the feasibility of different budgets and another information upon which forecast is based.

6.6 Audit of Interim Financial Reporting

6.6.1 Introduction

In refers to the audit of interim financial reporting. Interim financial reporting means financial reporting for a period which is shorter than a full financial year. It enhances the timeliness of the information and improves the ability of investors, creditors and others to take appropriate, economic decisions relating to reporting enterprise.

6.6.2 Definitions

As per Accounting Standard 25, 'INTERIM FINANCIAL REPORTING', it means a financial report containing either a complete set of financial statement or a set of condensed financial statement for an interim period which is shorter than full financial year.

Recognising this, clause 41 of listing agreements under SEBI requires the listed companies to publish quarterly financial results in the prescribed format.

6.6.3 Financial Statements

A complete set of financial statements generally includes–
1. Balance Sheet
2. Statement of Profit and Loss accounts.
3. Cash flow Statements.
4. Notes to Accounts and Accounting policies.

6.6.4 Objective

The objective of this standard is to prescribe the minimum contents of Interim Financial Report and the principles for recognition and measurement in a complete or condensed financial statement for an interim period.

6.6.5 Minimum Components of Interim Financial Report

An interim financial report should contain at least the following components :
1. Condensed Balance Sheet.
2. Condensed Profit and Loss Account.
3. Condensed Cash Flow Statement.
4. Selected Explanatory Notes.

An enterprise may present a complete set of financial statements. In case of complete set of financial statements it should be prepared as per the requirements of annual financial statements. However, a condensed interim financial report should include the following minimum information.

1. Headings and sub-totals that were included in the most recent annual financial statements.
2. Selected explanatory notes.
3. Additional items or notes the absence of which may make the reporting misleading
4. Basic and diluted earning per share for the interim period as per AS 20.

6.6.6 Principles of Recognition and Measurements

According to this standard there may be two distinctive principles of recognition and measurement of income and expenses in interim financial reporting :

- Integral view—An approach to measuring interim period income by viewing each interim period as an integral part of the annual period. Expenses are recognised in proportion to revenues earned through the use of special accruals and deferrals.
- Discrete view–An approach to measuring inteirm period income by viewing each interim period separately.

6.6.7 Minimum Disclosure of Notes

The Standard requires the disclosure of the following minimum information through notes and explanatory statements.

(a) A statement that the same accounting policies are followed in the interim financial statements as those followed in the most recent annual financial statements or if those policies have been changed, a description of the nature and effect of the change.

(b) Explanatory comments about the seasonality of interim operations.

(c) Unusual factors that affected assets, liabilities, equity, net income and cash flow.

(d) Effect of change in estimates

(e) Change in debt and equity through insurance, repurchase and repayments.

(f) Details of dividend payments

(g) Segment revenue, segment capital employed and segment results for the business segments in geographical segments, whichever is the primary basis of the reporting entity.

(h) Material event that occured after the end of interim period.

(i) Effect of changes in composition of the enterprise during interim period such as amalgamation, aquisition, restructuring, disposal of subsidiaries etc.

(j) Mateiral changes in contingent liabilities since the last balance sheet data.

6.7 Limited Review

A listed company, as per clause 41 of the listing agreement, has to furnish unaudited financial results on a quarterly basis in the prescribed format within one month from the end of each quarter to the Stock Exchange and also publish the same. The unaudited quarterly results have to be approved by the board of directors / its Sub-Committee and signed by the managing director / director. The quarterly results have to be subjected to a Limited Review by the auditor of the company and a copy of the Review Report has to be submitted to the stock exchange within two months after the close of the quarter. It may be noted that instead of publishing unaudited results wihtin one month followed by a Limited Review within two months, a listed company has the option to publish audited quarterly financial results within two months after the end of the related quarter.

6.8 Certificate on Corporate Governance

Clause 49 of the Listing Agreement requires that a listed company should comply with certain conditions of corporate governance as provided in that clause and should obtain a certificate from its statutory auditor as regards compliance thereof. This certificate is annexed to the Director's Report and must be sent to the stock exchange along with annual return.

6.9 Certificate on Cash Flow Statement

Clause 32 of the Listing Agreement requires that a company listed on a stock exchange has to give a cash flow statement also along with the balance sheet and profit and loss account and has to obtain a certificate from its statutory auditor relating to that. The cash flow statement has to be prepared in accordance with the indirect method as provided in AS-3. Asper AS-3, w.e.f., 14.2004, cash flow statement is attached with the balance sheet and profit & loss account and auditor gives reference of the some in this audit report.

6.10 Consolidated Financial Statements

Clasue 32 of the Listing Agreement requires a company listed on a stock exchange has to furnish a consolidated financial statements only audited by the statutory auditors in its annual report. The consolidated financial statements are in addition to the stand-alone financial statements of the parent company.

6.11 Questions

1. What is management audit? What are its objectives ?
2. State the techniques of management audit.
3. What is operational audit?
4. Describe the purpose and benefits of operational audit.
5. What steps do you consider necessary for conducting operational audit.
6. What is cost audit? State the provisions of the companies act relating to such audit. What are its advantages?
7. What is forecast audit? State the procedures of such audit?
8. Make out a distinction between audit of annaul accounts and audit of forecast accounts.
9. Write explanatory notes on the following :

a) Audit of interim financial reporting

b) Limited review.

c) Certificate on corporate governance.

Unit 7 ❒ Auditing in EDP Environment

Structure

7.0 Objectives

After reading and studying this unit the learners should be able to

- State the concept of EDP and its characteristics.
- Write the need for review of internal control under EDP system of accounting.
- Prepare the audit programme under EDP system
- Interpret the implication of computers for auditors.
- Explain about computer assisted audit techniques.

7.1 Introduction

With the advent of computers all business organisation are increasingly using computer for data processing. Computerisation generally affects organisation, controls, flow of documents and manner of information processing. It must always be appreciated that whatever method of data processing an enterprise uses, the basic objects of the audit are unchanged. Therefore, when a computer system is audited the duties and responsibilities of the auditor are exactly the same as if data were processed by manual or mechanical system. This unit, thus, deals with the development of EDP system of accounting and the major implications involved in auditing in a EDP environment.

7.2 Electronic Data Processing System (EDP System)

Electronic data processing (EDP) system denotes the use of digital computers and other data processing machines having electronic input for the purpose of collecting, sorting, analysing all types of information which signifies efficient conduct of business operations. It has revolutionised the accounting and control methods of business concerns in recent years. The main characteristics of EDP system are as follows :

- High Speed.
- Storage of huge information
- Advance software technology
- Accuracy
- Easy feed back
- Flexibility

7.3 Auditing in a Computer Environment

Audits should be executed in accordance with the auditors operational standard and with the guidance of the auditing guidelines. This is true of all audits including those of clients who have computerised accounting records. The basic approach to an audit is the same for all audits. However, there are some features of computerised systems which make it necessary to change some of the details of audit approach.

The auditor has to adapt himself to this revolution. However, it must be emphasised that the auditors duties remain same whatever the data processing are used.

7.4 Techniques of audit under EDP environment

The approach techniques adopted by auditors can be–

(a) **To Audit Round the Computer :**

This means treating the computer as a 'black box'. The auditor works at input and output but ignores what goes on in between. In this situation a substantive testing approach with analytical review is likely to be the most effective and economical method of listing.

(b) **Systems Evaluation :**

This has been seen as the best modern method for all audits but it does require the auditor to be well trained in EDP. The auditor will need to make detailed contact with the hardware and, with more difficulty the software.

In facts controls are strong enough to be relied on in very few systems. Therefore, the time spent on a detailed review of a system may be unproductive. However, some understanding of every system is necessary if the auditor is to have evidence that the organisation has maintained proper accounting records.

(c) Using the computer :

This means using :

(1) Established techniques such as test packs and computer audit programmes.

(2) Specially designed tests to be incorporated in the clients own processing. This will be necessary as real time systems become more common. They are known as embedded audit facilities.

7.5 Specific Problems of EDP audit

The auditor has to face the follwing special problems in relation to audit of computer systems.

(1) Much important information is held for long periods in non-visual form on storage devices, such as magnetic tapes and discs.

(2) The processing of data is carried out within the computer under the instruction of programs which are themselves in non-visual form and in computer language.

(3) The final visual output is often separated by a number of processing routines from the original input.

(4) These is often lack of audit trail, Audit trails means to trace any transaction sequentially through the system from their source to their completion and vice-versa.

(5) Computer systems can have programmed or automatic controls. It operation is difficult to check by an auditor.

(6) Clients may use an outside agency–a computer bureau—to maintain the accounting

records. This create considerable problems for an auditor in examining controls and systems where access is not a legal right.

7.6 Need for review of Internal Controls in EDP system of accounting

It is of course absolutely standard audit practice to begin by ascertaining, recording and evaluating the system of internal control, and this is even more important with computer systems, because of their complexity, than with other systems. The evalution of the system of internal control is most essential and considered to be the primary phase of audit in EDP system of accounting. The auditor, examines the design of internal control systems and also verifies how its actual workings corresponds to what was planned. This enables him to evaluate the reliance that can be placed on the processing system in producing reliable output. Since much controls are vital from the audit point of view, it would be highly appreciated if the management consults the auditor at the time of installation of electronic data processing devices in the accounting system. The active involvement of the auditor at the initial stages would help both the auditor and the management, to understand each others requirements and correlate them with the capacity of the system.

7.6 Internal Control in EDP System of Accounting

Important controls that should normally be found in a computer-based accounting system are :

a) Administrative control
b) Systems development control
c) Procedural controls (Controls over the processing of data)

Administrative control

It includes division of responsibilities, control over computer operators, file control and fire precautions and stand by arrangements.

Systems development control

This includes the following :

(i) Standard procedures and documentation
(ii) Systems and programme listing
(iii) File conversion
(iv) Acceptance and authorisation procedures
(v) System and programme amendments.

Procedure controls

This denotes the controls over processing of data which are of two types, namely, standing data and transaction data.

The procedural controls encompases the following controls :

(i) Input controls

(ii) Processing controls

(iii) Output controls

(iv) Master file controls

It may be emphasised that control over data is a continous process and the general overall aspect must be considered when dealings with any particular aspect.

7.7 Audit Implication of Computer aided auditing

The consequences for the auditor in computer aided auditing may be summarised as follows :

1. Knowledge and experience :

Technical knowledge and practical experience on the part of audit staff are an essential accompaniment to the planning and execution of all audit procedures. This may be gained from books, by attending courses, on-the-job training and by appointing computer technician to join the audit compliment.

2. Audit documentation

The documentation on the audit files must reflect the nature of the audit. Standard questionnaires and checklists must be redrafted accordingly, and the current files contain a record of all the client's EDP documentation, details of major controls included in the programmes, flow diagram of the systems etc.

3. Timing of tests

The auditor requires a totally revised approach to the timings of audit tests. When a complete and permanent record of all transactions, assets and liabilities is available at all times, audit rests on the records may be carried out at any convenient stage, by mutual agreement between client and auditor. In EDP systems, however, contemporary, as opposed to historical, testing is often an inescapable imposition.

4. The incidance of audit tests

Conventional records may be audited by vouching and checking the visible entries made at the very interface between the authorised and valid orginating documents, on the one hand, and the books of account, on the other. In EDP systems the recording counterpart takes place within the machine and no equivalent record is left for subsequent individual verification. For this reason the auditor is forced to shift the target of his tests, and to concentrate his effects on the following :

(a) Quality control over every stage in the creation of the input.

(b) The systems development control responsible for ensuring that the programmes function correctly.

(c) The administrative controls which are designed to ensure that the correct programmes are always used; that the staff observe designated job divisions, that hardware and files are physically secure and adequately secured by reconstruction and stan by facilities.

(d) The use made by managements of input records, particularly exception reports, and the control procedures governing rejection of invalid data.

(e) The need for this shift of incidence is understood when one realises that all tests 'through' the machine can, at best, provide indirection affermation on program functioning and although clearly better than nothing, such tests are always inferior, from the audit veiwpoint, to tests in which the accounting units may be scrutinized in their totality at the very point of their creation.

7.8 Computer Audit Programs

The auditors can use specifically written computer programmes to assist them with their audit. These can be used both to test the system of internal control and to assist the auditors with their balance sheet and profit and loss account verifications. The programme could have been specifically written by the auditor for use on particular client's computer, however, this is expensive and also requires considerable technical expertise. Therefore it will often be a generalized programme.

7.9 Auditing in a Computer Information System Environment (AAS 29)

The purpose of this Auditing and Assurance Standard is to establish standards on procedures to be followed when an audit is conducted in a computer information systems (CIS) environment.

Inportant features :

Following are the important features as stated by this standard :

1. The overall objective and scope of audit does not change in CIS environment.
2. The auditor should consider the effect of CIS environment on the audit.
3. The auditor should have sufficient knowledge of the computer information systems to plan, direct, supervise, control and review the work performed. In case of need, the auditor may seek the assistance of an expert prossessing the requisite skills.
4. The auditor should obtain an understanding of the accounting and internal control systems sufficient to plan the audit and to determine the nature, timing and extent of the audit procedure.

5. In planning the portions of the audit which may be affected by the CIS environment, the auditor should obtain an understanding of the significance and complexity of the CIS activities and the availability of data for use in the audit.

6. When the computer information system are significant, the auditor should also obtain an understanding of the CIS environment and whether it may influence the assessment of inherent and control risks. The nature of the risks and the internal control characteristics in CIS environments include the following :

- Lack of transaction trails.
- Uniform processing of transactions
- Lack of segregation of functions
- Potential for errors and irregularitis
- Initiation or execution of transactions
- Dependence of other controls and computer processing
- Potential for increased management supervision
- Potential for the use of computer-assisted audit techniques.

7. The auditor should make an assessment of inherent and control risks for natural financial statement assertions.

8. The auditor should consider the CIS environment in designing audit procedure to reduce audit risk to an acceptably low level.

9. The auditor should document the audit plan, the nature, timing and extent of audit procedures performed and the conclusions drawn from the evidence obtained. If audit evidence exists in electronic form, the auditor should satisfy himself that such evidence is adequately and safely stored and is retrievable in its entirety as and when required.

7.11 Questions

1. What do you mean by EDP system?
2. Explain the audit techniques used in EDP environment.
3. State the need for review of internal controls in EDP system of accounting.
4. Mention the specific problems of EDP audit.
5. Explain in detail the internal control system in EDP environment.
6. Describe the audit implication of computer aided auditing.
7. State the important features of AAS 29 in respect of auditing in computerised environment.
8. Write Short notes :
   a) Computer audit programmes
   b) Audit trails.

Unit 8 ❐ Professional Ethics and Code of Conduct

Structure

8.0 Objectives

After reading and studying this unit the student should be able to

- State the meaning of the term 'Professional Ethics'.
- Distinguish between Professional Misconduct and Professional negligence.
- Describe the code of conduct prescribed by the ICAI. (The Institute of Chartered Accountants of India).
- Write the procedure to be followed to maintain and enhance the quality of audit.
- Highlight the emerging issues of audit in the present day context.

8.1 Introduction

Auditing is carried out by accountants in public practice. Accountancy is a profession. Professions have certain characteristics including an ethical code and rules of conduct. Professional accountants are required to observe proper standards of professional conduct whether or not the standards required are written in the rules or are unwritten. They are specifically required to refrain from misconduct resulting in discredit on himself, his professional body or the profession generally.

This unit, thus, is mainly concerned with the professional ethics, codes of conduct as prescribed by the professional bodies. It also includes discussion about the emerging and dynamic issues in audit alongwith the standard prescribed for maintaining and enhancing the quality of audit.

8.2 Profession

Dictionaries define and describe a profession as a calling or vocation involving some branch of learning. Clearly accountancy does involve a body of knowledge as is well known to students who are endeavouring to acquire it.

The idea of a profession rests of the following premises:

a. recognisable discreate body of knowledge.
b. an educational process.
c. a system of examinations.
d. a system of licensing practitioners.
e. a professional association.
f. a sense of responsibility to society.
g. a code of ethics.
h. a set of technical standards.

All of these premises can be applied to the accountancy profession.

8.3 Professional Ethics

8.3.1 Importance

A trademark of professionals is their willingness to accept a set of professional and ethical principles and follow these principles in the conduct of their daily affairs. The acceptance of these principles require that professionals maintain a higher standard of conduct than is called for by law. Professionals are required to consider carefully the implications of alternative actions and to conduct themselves in a manner that is not only lawful but proper.

Ethical conduct by members of professions is highly valued in our society. Codes of conduct, codes of ethics and canons of law provide ample evidence of these values. Even without codes and canons, professionals should feel a strong objection to act ethically because it is in the best interests of both themselves and society.

The Chartered Accountants occupy an important position in the financial sector of the country. In fact they are ensure that enterprises and organisations audited by them maintain adsolute transparency so far as their financial transactions are concerned. The need for transparency arises because it is only with transparency there would be accountability.

The increasing pace of globalisation and the integration of the Indian economy with the global economy is also bringing about a paradigm shift in the acounting standards practised by Indian enterprises. Probably the globably accepted accounting practices will become the norm in the country very soon. As India integrates more closely with the global economy it is necessary that the principles of corporate governance, which basically focus on transparency, acountability and creation of value for the stakeholders are effectively practised. It is here that the Chartered Accountants have a very important role to play. Through their practice of the profession, they must ensure that the standards of business ethics are maintained at the highest level not only by them as professionals, but in the enterprises audited by them. Rabindranath Tagore said that only a lighted candle could light another candle. Only ethically strong Chartered Accountants can ensure that the Indian business enterprises also practice the highest standards of business ethics.

8.3.2 Concept and Definitions

Professional ethics refer to the basic principles of right action for the members of a profession. It signifies the behaviour of a chartered accountant (professional) towards his felows in the profession and other professions and towards members of the public.

A few important definitions are given below:

As per American Heritage Dictionary professional ethics may be defined as "the study of the general nature of morals and of the specific moral choices to be made by the individual in his relationship with others". The choices we make determine our ethical values and the image we project to others.

"Professional ethics may be regarded as a mixture of moral and practical concepts, with a sprinkling exhortation to ideal conduct designed to evoke right action on the party of the members of the profession concerned. (Carey and Daherty)

The professional ethics aims at curbing the selfish interest of the professional accountants and thus to arouse their goodness in order to serve the society by accepting those areas of responsibility which goes beyond what the law demands. (Sould Levy)

The International Federation of Accountants (IFAC) recognises that the distinguishing characteristics of a profession include

- Adherence by its members to a common code of values and conduct.
- Acceptance of a duty to society as a whole.
- Accountancy profession has also the responsibility towards, 'credit grantors, governments, employers, employees, investors, the business and financial community, and others who rely on the objectivity and integrity of the professional accountants to maintain the orderly functioning of commerce.

According to IFAC the following to be the fundamental principles by which an accountant should be governed in the conduct of his professional relations with others.

Integrity

A professional accountant should be straightforward and honest in performing professional services.

Objectivity

A professional accountant should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity.

Independence

The auditor should maintain an impartial attitude and both be and appear to be free of any interest that might be regarded, whatever its actual effect, as being incompatible with integrity, objectivity and independence. The auditor should be independent in fact and appearence.

Confidentiality

The auditor should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

Professional competence and due care

In agreeing to provide professional services, the auditor implies that a certain level of competence is necessary to perform professional services and that the knowledge, skill and experience of the auditor will be applied with reasonable care and diligence. Auditors should therefore refrain from performing any services that they are not competent to carry out useless advice and assistance are obtained to ensure that the services are performed in a satisfactory manner. An auditor should perform professional services with due care, competence, and diligence. He or she has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service based on up-to-date developments in practice, legislation and techniques.

Technical Standards

An auditor should carry out professional services in accordance with the relevant technical and professional standards. Auditors have a duty to carry out, with care and skill, the instructions of the client or employer insofar as they are compatible with the requirements of integrity, objectivity and independence.

8.4 Code of Conduct

Most professions have written codes of professional conduct and there is a general commonality among them.

1. Members of each profession are usually expected to maintain a higher standard of conduct than is required by law.
2. The principles, codes and canons of each profession are usually designed to encourage ethical conduct and project a positive image to the public.
3. Professions also expressly prohibit certain acts on the part of their members. These acts are not compatible with the ethical standards that ensure quality work, clients' trust, and a positive public image.

The introduction to code of ethics of the Institute of Chartered Accountants of India states: "For the success of the profession of accountancy a self-imposed code of ethics is essential to command the respect and confidence of the general public. Chartered Accountants in the service of the affairs of others have responsibilities and obligations to those who rely on their work".

The conduct of the member of the profession in India, prior to 1949, when it was controlled by the government was judged with reference to certain sets of rules and Regulations. This pattern of code of conduct was formulated in 1949 and incorporated in Chartered Accountants Act, 1949 and the schedules thereto, setting out different forms of behaviour which would constitute professional misconduct under the law. The code of professional conduct was adopted to provide guidance and rules to all members. Those in public practice, industry, government, and education in the performances of their professional responsibilities. The reason for a code of conduct is to encourage members to exercise self-discipline above and beyond laws and regulations. It may be noted here that to fulfil the expectations of the various sections of our economy served by the profession, the code of conduct needs through review. Consistent with the objects of professional ethics to maintain credibility, professionalism, quality of services and confidence.

8.5 Professional Misconduct

Section 22 of the Charterd Accountants Act 1949 defines professional misconduct as deemed to be including any act or omission specified in any of the schedules to the Act.

The Act specifies a number of acts or omission in various schedules which may be construed as professional misconduct.

8.6 Professional Negligence

It is an act of commission or omission which occurs becuase the person concerned has failed to exercise the degree of professional care and skill which is expected of him under the circumstances of the case.

8.7 Difference between Professional Misconduct and Professional Negligence

Professional misconduct denotes situation arising from the violation of rules and regulation as laid down in the Chartered Accountants Act 1949.

Professional negligence on the other hand implies failure to perform duty or duties resulting in damage or loss to the clients.

8.8 The Chartered Accountants Act, 1949 and Professional Misconduct

Diagramatic representation of the Act as regards Professional Misconduct

C.A. Act

- First Schedule
  - Part -I
    - Member in Practice
  - Part-II
    - Member in Service
  - Part-III
    - All Members
- Second Schedule
  - Part-I
    - Member in Practice
  - part-II
    - All Members

A. Part I of First Schedule

It contains thirteen clauses which specify certain circumestances in which a chartered accountant in practice is deemed to be guilty or professional misconduct.

Clause 1. If he allows any person to practise in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by himself.

Clause 2. If he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner.

Clause 3. If he accepts or agrees to accept any part of the profits of the professional work of a lawyer, auctioneer, broker or other agent who is not a member of the Institute.

Clause 4. If he enters into partnership with any person other than a chartered accountant in practice or a person resident without India who but for his residence abroad would be entitled to be registerered as a member under clause (v) of sub-section 1 or section 4 or whose qualification are recognised by the central government or the council for the purpose of permitting such partnerships, provided that the chartered accountant shares in the fees or profits of the business of the partnership both within and without India.

Clause 5. If he secures, either through the services of a person not qualified to be his partner or by means which are not open to a chartered accountant, any professional business.

Clause 6. If he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Clasue 7. If he advertises his professional attainments or services, or uses any designation or expressions other than chartered accountant on professional documents, visiting cards, letter heads or sign-board, unless it be a degree of a university established by law in India or recognised by the central government or a title indicating membership of the Institute of Charterd Accountants or of any other institution that has been recognised by the central government or may be recognised by the council.

Clause 8. If he accepts a position as auditor previously held by another Chartered Accountant or a Restricted State Auditor without first communicating with him in writing.

Clause 9. If he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956, in respect of such appointment have been only complied with.

Clasue 10. If he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings or results of such employment, except in cases which are permitted under any regulations made under this Act.

Clause 11. If he engages in any business or occupation other than the profession of chartered accountants unless permitted by the council so to engage. Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company, unless he or any of his partners in interested in such company as an auditor.

Clause 12. If he accepts a position as auditor previously held by some other chartered accountant of a Restricted State Auditor in such conditions as to constitute undercutting.

Clause 13. If he allows a person not being a member of the Institute or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

B. **Part II of First Schedule**

It contains three clauses which specify certain circumstances in which a member of the Institute, being an employee of any company, firm or person, shall be deemed to be guilty of professional misconduct.

Clause 1. If he pays or allows or agree to pay directly or indirectly to any person any share in the emoluments of employment undertaken by him.

Clause 2. If he accepts or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm, person or agent or customer of such company, firm or person by way of commission or gratification.

Clause 3. If he discloses confidential information acquired in the course of his employment except as and when required by law or except as permitted by the employer.

C. **Part III of First Schedule**

As per Part III of the First Schedule to the Chartered Accountants Act, any chartered accountant (whether in practice or not) would by guilty of professional misconduct :

1. If he includes in any statement, return or form to be submitted to the council any particulars knowing them to be false.
2. If he, not being a Fellow, styles himself as a fellow
3. If he does not supply the information called for, or does not comply with the requirements asked for, by the council or any of its committees.

D. **Part I of Second Schedule**

A chartered accountant in practice shall be deemed to be guilty of professional misconduct in any of the ten situations mentioned below.

Clause 1. If he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of his client or otherwise than as required by any law for the time being inforce.

Clause 2. If he certifies or submits in his name or in the name of his firm a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee of his firm or by another chartered accountant in practice.

Clause 3. If he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

Clause 4. If he expresses his opinion on financial statements of any business or any enterprise in which he, his firm or a partner in his firm has a substantial interest, unless he discloses the interest also in his report.

Clause 5. If he fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary to make the financial statement not misleading.

Clause 6. If he fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity.

Clause 7. If he is grossly negligent in the conduct of his professional duties.

Clause 8. If he fails to obtain sufficient information to warrant the expression of an opinion or his exceptions are sufficiently material to negate the expression of an opinion.

Clause 9. If he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

Clause 10. If he fails to keep moneys of his client in a separte banking account or to use such moneys for purpose of which they are intended.

E. **Part II of Second Schedule**

It contains two rules of misconduct which are applicable to all chartered accoutants, whether in practice or not.

Clause 1. A member of the Institute, whether in practice or not shall be deemed to be guilty or professional misconduct, if he contravens any of the provisions of this Act or the Regulations made there under.

Clause 2. A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he is guilty of such other act or omission as may be specified by the council in his behalf, by notification in the gazette of India.

8.9 Few illustrative cases of Professional Misconduct

(i) A chartered accountant in practice pays 25 per cent of his professional fees to the widow of his deacesed partner purely on humanitarian grounds.

This amounts to professional misconduct in the absence of a clause in the partnership agreement to this effect.

(ii) A chartered accountant in practice forms a partnership with a member of ICAI who does not hold a certificate of practice.

The chartered accountant is guilty of professional misconduct since a chartered accountant in practice can enter into professional partnership only with another chartered accoutant in practice.

(iii) A chartered accountant in practice does not disclose in the audit report a material departure in the financial statements from a mandatory accounting standard of ICAI.

The chartered accountant is guilty of professional misconduct.

(iv) A chartered accountant in practice accepts the appointment as tax auditor of a company without communicating with the previous auditor.

He is guilty of professional misconduct. The requirement for communication with the previous auditor applies to all audit assignments.

8.10 Quality Control for Audit Work (AAS-17)

The objective of this standard is to prescribe the procedures so that quality of audit conducted by the audit firm is maintained and enhanced. It prescribes :

(a) Policies and procedures of an audit firm regarding audit work generally; and

(b) Procedures regarding the work delegated to assistants on the individual audit.

This standards require that quality control policies and procedure should be implemented at both the level of the audit firm and on individual audits.

8.10.1 Quality control for audit firm

This standard prescribes that audit firm should comply all the auditing standards so that quality of audit is ensured.

Quality control of firm level can be ensured by following the undermentioned policies.

(a) Professional Requirements :

Personnel in the firm are to adhere to the principles of independence, integrity, objectivity, confidentiality and professional behaviour.

(b) Skills and competence :

The firm is to be staffed by personnel who have attained and can maintain the technical standards and professional competence required to enable them to fulfil their responsibility with due care.

(c) Assignment :

Audit work is to be assigned to personnel who have the degree of technical training and proficiency required in the circumstances.

(d) Delegation :

There is to be sufficient direction, supervision and review of work at all levels to provide resonable assurance that the work performed meets appropriate standards of quality.

(e) Consultation :

Whenever necessary, consultation within or outside the firm is to occur with those who have appropriate expertise.

(f) Acceptance and returning clients :

An evaluation of prospective clients and a review, on an ongoing basis, of existing clients is to be conducted. In making a decision to accept or retain a client, the firm's independence and ability to surve the client properly are to be considered.

(g) Monitoring :

The continued adequacy and operational effictiveness of quality control policies and procedures is to be monitored.

8.10.2 Quality control of individual audit

Whether the particular audit is being carried as per generally accepted auditing standards (GAAS) the following points should be considered to ensure that particular client's audit quality is as per generally accepted auditing standards–

1. Professional competence of assistant deployed in particular audit.
2. Audit programme or direction to audit assistants for conducting the audit.

3. Continuous supervison by senior audit assistant.

4. Periodical review of audit by the partner.

5. Certain additional audit procedures by the personnel other than personnel deployed in particular audit.

8.11 Emerging Issues

Few emerging significant issues in auditing which are currently in focus or are likely to be so in the year to come are discussed here.

8.11.1 Social Audit

Social audit encompasses an assessment of what an enterprise contributes to the society and what it takes away from it. A good number of efforts are being made to devise techniques that measure the contrubution of an enterprise to the society. At the time of introduction of MAOCARO in 1975 (now CARO '03) it was claimed that "regulatory social audit was being introduced and the main objective of the order was to ensure that the social objective of company by chartered accountants is achieved in greater measure considering the basic fact that under modern condition companies have to subserve public interest rather than private gain of the investors." These developments are the result of growing realisation that enterprises have social responsibilities and that their performance as a whole should be taken into consideration.

Many proposals have been put forward to design an extended accounting system which measure the social performance of an enterprise. Some important elements involving social contribution of an enterprise are discussed below :

Relations with people

Training programmes for handicapped workers, contribution to schools for employees, extra cost incurred on hiring persons from minority or suppressed communities, health-care programmes, spreading of literacy, women empowerment process, eudcation and training for sustainable livelihood etc. would constitute the contribution of the enterprise for improving the relations with people.

Relations with environment

Commitment to sustainable development primarily requires environment protection and its proper conservation. Achieving improvement in eco-efficiently in all operations, setting standard in environment management, actively participating in social welfare and environment development activities for the near by communities etc. constitute the contribution of the enterprise in improving the relations with environment.

Relations with product

In measuring the total performance of an enterprise vis-a-vis the society generally, factors like human resource contribution, public contribution, environmental contributions, product or service contribution and net income of the enterprise are considered.

In absence of any acceptable standards of measuring the total social performance of an enterprise, in India they can use value added statements to show their contribution to national economy.

In India, the report of the social audit committee was released in 1980 by Tata Steel (TISCO). Now-a-days a large number of companies include social reporting in the board of directors report. A paragraph taken from the directors report relating to social report is reproduced below in respect of Indian Alluminium Company Ltd.

"Beyond business..."

"For us in the Aditya Birla Group success is measured by how well we fulfil our economic, environmental and social responsibility. This "triple-bottom-line" accountability lies at the heart of our group, factoring as it does holistically the interest of all of our shareholders—shareholders, customers, employeers and community at large."

8.11.2 Environmental Audit

Environment accounting and auditing have gained special importance to recent years because protection of environment has become the prime corporate responsibility in achieving the aim of sustainable development.

Environmental audit is defined as a systematic process of obtaining and objectively evaluating the evidence relating to performance of an organisation as reflected in environmental statements. It attempts to examine and report on verifiable quantitative or qualitative information in the areas of environment concerns.

A growing number of companies are now valuntarily disclosing environmental information, both as stand-alone corporate reports and as special environmental or sustainability sections within corporate annual reports. Environmental accounting measures and discloses the impact of activities of an organisation on the environment. It is viewed by the corporates that meeting the needs of today should be fulfilled without compromising the welfare of the future generations. These has been tremendous intrinsic linkage between economic growth and environment protection.

An environment audit normally requires a multi-disciplinary audit team as this audit involves specialised skills which a single individual is not likely to process.

In India, as per Environment (Protection) Act. each organisation which requires consent under the Act relating to environment should submit an environmental audit report for the financial year ending 31 March to the concerned State Pollution Conrol Board by May 15 each year. This report although not compulsory to be audited, contains the following information :

a) Water and raw material consumption

b) Water and pollution generated (Specifying the variation with the standards)

c) Quantities and characteristics of hazardous and solid wastes

d) Impact of pollution control measure on conservation of natural resources on and cost of production and

e) Additional investment proposals for environmental protection.

Keeping in view the serious implications of the adverse impact of the activities of an organisation on environment a large number of enterprises have started conducting audit of environmental performance and legal compliance by the internal auditor or environment auditor and publsih environment policy statment each year with their annual reports.

8.11.3 Peer Review

In view of improving and monitoring the quality of auditing in India the Institute of Chartered Accountants of India has introduced the concept of peer review.

Peer review is a system by which the quality of attestation work of an auditor is examined by another professional of similar standing (Peer). The reviewer examines whether the auditor under review, in performing his professional assignments, have complied with technical standard and implemented proper quality control systems and procedure including documentation.

The ultimate odjective of the peer review is to maintain and enhance the quality of professional work.

8.12 Questions

1. What do you mean by professional ethics and state its relevance in the context of accountancy and auditing profession.
2. Discuss the basic principles by which a professional accountant should be governed in the conduct of his professional relations with others.
3. What is difference between professional misconduct and professional negligence ?
4. Explain the concept of code of conduct.
5. Explain the provisons contained in Part-I of both First and Second schedule to the Chartered Accountants. Act 1949 in respect of professional misconduct for the chartered accountants in practice.
6. Write short notes on the following.

a) Quality control of audit.
b) Social audit.
c) Environment audit
d) Peer review.

8.13 Suggested Readings

1. Contemporary Auditing (6th Edition)–Kamal Gupta, Tata McGraw Hill
2. Auditing Today (6th Edition)–Emile Woolf, Prentice Hall
3. An Insight into Auditing–A Multidimensional Approach, By Dr. B. K. Basu, Basusree Book Stall, Kolkata-73

4. A Handbook of Practical Auditing
–B. N. Tandon
–S. Sudharsanam
–S. Sundharabahu
S. Chand & Company Ltd., New Delhi
5. Students Guide to Auditing Standards
By D. S. Rowat, Taxman
6. Students' Guide to Accounting Standards
By D. S. Rowat, Taxman
7. Accounting Standards and Corporate Accounting Practice, T. P. Ghosh, Taxman
8. Indian Accounting Standards., A Bhattacharya TATA McGrawall.