

UNIT-V

SUBJECT CODE: CCM52

AUDITOR'S REPORT

Auditor's Report – Importance of auditor's report – contents of audit report – Kinds of reports.

AUDITOR'S REPORT

In the end, the management auditor prepares a report. On the basis of findings and definite information, the auditor prepares a report making suggestions for improvement in the working of the management. His report should give a correct assessment of the working of organization. He should not hesitate in criticizing the management. His recommendations should be constructive and not merely condemning in nature. His report may include the following matters:

1. Whether the management; and the staff relations are healthy.
2. Whether the return to shareholders is adequate.
3. Whether the methods of production are out-dated.
4. Comparison of operating efficiency of the organization with other concerns.
5. Rate of the return on investment.

Contents of Audit Report

Under section 227 (2) every auditor is required to make report to the shareholders on the accountants examined by him and every balance sheet and profit and loss A/c and every document declared by law to be part of or annexed to the balance sheet and profit or loss A/C which are placed before the shareholders of the company at the general meeting during tenure of his office. The report has to state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accountants give the information required by the Companies Act in manner so required and give a true and fair view.

i. In the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and

ii. In the case of profit and loss account, of the profit or loss account for its financial year.

Sub-section (iii) of the section 227 required that the auditor's report shall also state.

a. Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit;

b. Whether in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of these books, and proper returns adequate

for the purposes of his audits have been received from the branches not visited by him .

c. Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

d. Whether the company's balance sheet and profit and loss A/C dealt with by the report are in agreement with the books of accounts and returns.

If any of the matters as referred to in section 227 (2) and (3) is answered in the negative or with the qualification the auditor has to state in his report the reasons for such answer.

The Auditor's report shall also include a statement on such additional matters as specified by the Central Government under section 227 (4-A) of the Companies Act, This section empowers the Central Government to order the inclusion of certain matters in the auditor's report. The Institute of Chartered Accountants of India requires the auditor's to ensure that the accounting standards are implemented in the presentation of financial statements covered by their audit reports. The deviation should be reported in the report

Difference between Investigation and Audit

An Audit is carried out to ensure that the balance Sheet and the profit and Loss A/C show a true and fair picture. But, on the other hand, an investigation is carried out on for some predefined purpose e.g. to know the financial position of the company or its earning capacity.

An Audit is limited only for an examination of the accounts of the concern but the investigation covers not only examination of accounts, it involves probing deep into the matter and looking for required information far behind the books whenever necessary.

The Investigation is not legally compulsory but audit is statutorily compulsory in case of joint stock companies.

Auditing can only be conducted by a chartered accountant but it is not necessary that an investigator must be a Chartered accountant.

An audit is always carried out on behalf of the owner of the business, but the investigation may be conducted on behalf of the proprietor of the business, in case he suspects any fraud, or on behalf of the outside parties.

An audit always relates to a period of 1 year or 6 months but the investigation may cover several years.

Investigation is done when the books of accounts are already subject to a regular audit i.e.

The investigation starts where the audit ends.

Unlike auditor, an investigator is not bound by accounting conventions, policies and Disclosure requirements.

Qualified opinion /report

Qualified report is given by the auditor in either of these two cases:

When the financial statements are materially misstated due to misstatement in one particular account balance, class of transaction or disclosure that does not have pervasive effect on the financial statements.

When the auditor is unable to obtain audit evidence regarding particular account balance, class of transaction or disclosure that does not have pervasive effect on the financial statements.

The report is mostly like a Clear Opinion Report and only includes a paragraph viz. Basis for Qualification after Scope paragraph and before Opinion paragraph. Opinion paragraph in addition to its standard wording includes —except for the matter described in Basis for

Qualification paragraph the financial statements give true and fair view.¶

Detailed below:

A **Qualified Opinion** report is issued when the auditor encountered one of the two types of situations which do not comply with generally accepted accounting principles, however the rest of the financial statements are fairly presented. This type of opinion is very similar to an unqualified or "clean opinion", but the report states that the financial statements are fairly presented with a certain exception which is otherwise misstated. The two types of situations which would cause an auditor to issue this opinion over the unqualified opinion are:

Single deviation from GAAP – this type of qualification occurs when one or more areas of the financial statements do not conform with GAAP (e.g. are misstated), but do not affect the rest of the financial statements from being fairly presented when taken as a whole. Examples of this include a company dedicated to a retail business that did not correctly calculate the depreciation expense of its building. Even if this expense is considered material, since the rest of the financial statements do conform with gaap, then the auditor qualifies the opinion by describing the depreciation misstatement in the report and continues to issue a clean opinion on the rest of the financial statements.

Limitation of scope – this type of qualification occurs when the auditor could not audit one or more areas of the financial statements, and although they could not be

verified, the rest of the financial statements were audited and they conform to GAAP. Examples of this include an auditor not being able to observe and test a company's inventory of goods. If the auditor audited the rest of the financial statements and is reasonably sure that they conform with GAAP, then the auditor simply states that the financial statements are fairly presented, with the exception of the inventory which could not be audited.

The wording of the qualified report is very similar to the unqualified opinion, but an explanatory paragraph is added to explain the reasons for the qualification after the scope paragraph but before the opinion paragraph. The introductory paragraph is left exactly the same as in the unqualified opinion, while the scope and the opinion paragraphs receive a slight modification in line with the qualification in the explanatory paragraph.

The scope paragraph is edited to include the following phrase in the first sentence, so that the user may be immediately aware of the qualification. This placement also informs the user that, except for the qualification, the rest of the audit was performed without qualifications: "Except as discussed in the following paragraph, we conducted our audit..."

The opinion paragraph is also edited to include an additional phrase in the first sentence, so that the user is reminded that the auditor's opinion explicitly excludes the qualification expressed. Depending on the type of qualification, the phrase is edited to either state the qualification and the adjustments needed to correct it, or state the scope limitation and that adjustments could have but not necessarily been required in order to correct it.

For a qualification arising from a deviation from GAAP, the following phrase is added to the opinion paragraph, using the depreciation example mentioned above:

"In our opinion, except for the effects of the Company's incorrect determination of depreciation expense, the financial statement referred to in the first paragraph presents fairly, in all material respects, the financial position of..."

For a qualification arising from a scope of limitation, the following phrase is added to the opinion paragraph, using the inventory example mentioned above:

"In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to perform proper tests and procedures on the Company's inventory, the financial statement referred to in the first paragraph presents fairly, in all material respects, the financial position of..."

Unqualified Opinion

An opinion is said to be **unqualified**, or unmodified, when the Auditor concludes that the

Financial Statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the Financial Statements. An Auditor gives a Clean opinion or Unqualified Opinion when he or she does not have any significant reservation in respect of matters contained in the Financial Statements. The most frequent type of report is referred to as the "Unqualified Opinion", and is regarded by many as the equivalent of a "clean bill of health" to a patient, which has led many to call it the "Clean Opinion", but in reality it is not a clean bill of health, because the Auditor can only provide reasonable assurance regarding the Financial Statements, not the health of the company itself, or the integrity of company records not part of the foundation of the Financial Statements.^[2] This type of report is issued by an auditor when the financial statements are free of material misstatements and are presented fairly in accordance with the Generally

Accepted Accounting Principles (GAAP), which in other words means that the company's financial condition, position, and operations are fairly presented in the financial statements. It is the best type of report an auditee may receive from an external auditor.

An Unqualified Opinion indicates the following –

The Financial Statements have been prepared using the Generally Accepted Accounting Principles which have been consistently applied;

The Financial Statements comply with relevant statutory requirements and regulations;

There is adequate disclosure of all material matters relevant to the proper presentation of the financial information subject to statutory requirements, where applicable;

Any changes in the accounting principles or in the method of their application and the effects thereof have been properly determined and disclosed in the Financial Statements.

Objectives of Investigation

The real objective of conducting an investigation by an auditor on behalf of his client is to provide him the desired information in the form of a report about the matter specified. Normally the objective of investigation is to collect, analyze and evaluate facts in respect of desired field of activity with a view on some special purpose as determined by the person on whose behalf the investigation is undertaken. In short investigation is to ascertain the financial position and earning capacity of a business on behalf of a certain person.

The common objectives of investigation are listed below:

- 1) Proposed purchase of business.
- 2) Proposed sale of business.
- 3) Reasons for low profitability.
- 4) Cause of high employee turnover.
- 5) Reliability of business data.
- 6) Proposed investment in particular securities.
- 7) Suspected fraud.
- 8) Joining in existing partnership business.
- 9) Borrowing funds.
- 10) Lending funds.
- 11) Proposed purchase of controlling shares in a company.
- 12) Suspected misfeasance against directors.
- 13) Detection of undisclosed income for tax purposes.
- 14) Suspected misappropriation by trustees.

DUTIES OF AN AUDITOR

Duties of an auditor can be stated under two heads : A. Duties under the Companies Act; and B. Duties as per the Legal Decisions. Let us see these duties under these heads separately.

A. Duties under the Companies Act

The auditor has the following duties under the Companies Act:

1. To make special enquiries and investigations in connection with the following matters (Sec. 227 (IA)).

- (i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interest of the company of its members;
- (ii) whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company;
- (iii) where the company is not an investment company within the meaning of Section 372 or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company ;
- (iv) whether loans and advances made by the company have been shown as deposits ; (v) whether personal expenses have been charged to revenue accounts ;

(vi) whether it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

2. To make report to the shareholders. (Section 227 (2, 3 & 4)).

The auditor of the company is duty bound to make report to the members of the company on the accounts examined by him and on every balance sheet, every profit and loss account laid before the company in the general meeting during his tenure of office. The auditor has to make a report to the members and not to the directors, though his appointment may have been made by the directors. The duty of the auditor is over as soon as he submits the report to the Secretary of the company. It is none of his concern to know whether the same has reached to the hands of the members of the company.

The Audit Report must expressly state the following besides other necessary things ;

(a) whether in his opinion and to the best of his information and according to the explanations given to him the accounts give the information required by the Act and in the manner so required.

(b) Whether the balance sheet gives true and fair view of the company's affairs as at the end of the financial year and the profit and loss account gives a true and fair view of the profit and loss of its financial year;

(c) whether he has obtained all the information and explanations required by him for the purposes of his audit;

(d) whether, in his opinion, proper books of account as required bylaw have been kept by the company, and proper returns for the purposes of his audit have been received from the branches not visited by him;

(e) whether the company's balance-sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.

3. Duty to state the reasons for the answers in negative.

In case of the answers to any of the points stated above are in negative, the auditor is required to explain the reason for the answer in his report.

4. Duty to include in the report the matters as directed by the Central government.

Section 227 (4A) empowers the Central Government to require by order, that the auditor's report will include a statement on such matters as may be specified therein. Before making any such order the Central Government may consult the Institute of Chartered Accountants of India in regard to the classes of description or companies and other ancilliary matters

proposed to be specified therein.

5. Duty to sign the audit report. (Section 229).

It is the duty of the auditor to sign the audit report before sending it to the secretary of the company.

6. Duty to give a report upon the Prospectus (Section 56 (1)).

The auditor is required to give his report upon the Prospectus issued by an existing company. He should also give his report on the assets, liabilities and Profit and Loss of such company.

7. Duty to certify the Statutory Report. (Section 165 (4)).

The auditor has to certify the correctness of the Statutory Report with regard to the following:

- (a) the number of shares which have been allotted by the company whether for cash or for consideration other than cash;
- (b) the total amount of cash received by the company in respect of all the shares allotted, distinguished as aforesaid;
- (c) an abstract of the receipt of the company and the payments made.

8. Duty to declare the solvency of the Directors, (Section 488 (2) (b)),

The auditor has to declare that solvency of the directors in case of the Voluntary Liquidation of the company,

9. Duty to give a report upon the Profit and Loss Account and the Balance Sheet enclosed with the Declaration of Solvency. (Section 488 (2) (b)).

The auditor has to give his report upon the profit and loss account and the balance sheet which is enclosed with the Declaration of solvency made by the Directors of the company, in the case of Voluntary Liquidation of the Company,

10. Duty to assist the Investigators (Section 240 (v) (b)).

In case the affairs of the company are to be investigated, the auditor should assist the Investigators in every possible manner. He should produce his working papers relating to audit when asked for by the Investigators.

11. Duty to assist the Advocate General.

If the Advocate General is making any enquiry against the directors, the auditor is duty bound to help him in his work.

B. Duties According to the Legal Decisions

Certain matters have been taken to the court of law from time to time and the courts have in their decisions fixed certain duties upon the auditors. These duties in short are enumerated here.

1. Duty to inform the members and shareholders about the contravention of the provisions of the company Law.

2. Duty to enrol himself with the Institute of Chartered Accountants of India and to obtain a certificate to practice from it.

3. Duty to acquaint himself with the provisions of the company law and also enquire from his predecessor about it in writing,

4. Duty not to canvass for and also approach and press any member of the company for his appointment as an auditor of the company.

5. Duty to enquire about the true and fair state of affairs of the company and submit his proper report.

6. Duty to verify himself cash in hand and not to be negligent in his work.

7. Duty to see the Debenture Trust Deed and verify whether the debentures issued by the company are according to the terms laid down in the trust Deed.

8. Duty to verify the investments himself.

9. Duty to perform his task with ability, care and skill.

10. Duty to verify the inventories and the ledger accounts.

11. Duty to personally inspect all securities and see that they are in the safe custody of the Secretary of the Company.

Various courts have penalised the auditors for non-performance of the above stated duties and therefore, the auditor should take note of these duties also.

Classes of Investigation:

There are many types of Investigation, but certain main classes can be identified. Following are some of the areas where the investigation is mostly called for:

1. Investigation on behalf of a person or company who wants to purchase a running business.

2. Investigation on behalf of a person who is interested to join as a partner in a partnership firm.

3. Investigation on behalf of a person who wants to lend money to a business or interested to know its financial position.

4. Investigation on behalf of the owner/shareholder of the business who suspects a fraud.

5. Investigation on behalf of the tax authority for assessing actual tax liability.

Comprehensive audit

The primary purpose of a comprehensive audit is to ascertain the economy, efficiency and effectiveness of an organization's operations and use of resources. Comprehensive audits are also called "value for money" audits and are designed to be wide ranging and thorough,

integrating financial auditing, corporate compliance, operational audit procedures and management reviews. Comprehensive audits have also been performed on regional governments to combat fraud and corruption.

Levels

Comprehensive audits can be performed on the entire company or at the level of a specific department, such as finance management, human resources or information systems. Any audit of a public company is required to be conducted by an accounting firm registered with the Public Company Accounting Oversight Board (PCAOB) and should include the full range of the company's activities.

Risk

Risk assessment is a part of a comprehensive audit. It is based on the nature, quantity and quality of evidence, and the professional independent auditor's judgment in interpreting the evidence. It also includes the company's internal controls over financial reporting to reduce the risk of error or fraud.

Responsibility

A comprehensive audit examines the Management Control Framework (MCF) of the company, which would identify the division of responsibility within the company or the areas covered by the audit. This includes an analysis of the company's internal audit procedures, quality controls and quality reviews. The auditor should also assess the effectiveness of the company's internal controls over financial reporting. It is the auditor's professional responsibility to exercise professional skepticism that includes an inquiring mind and independent critical assessment.

Recommendations

A comprehensive audit report will include recommendations on how to improve procedures and activities and enhance economy, efficiency and effectiveness in all areas covered by the audit. It will also include the auditor's opinion on the company's financial statements.

Concept of Social Audit:

Although no unanimous definition has yet been evolved, the term Social audit, in its simple sense, may be defined as the audit of the social responsibilities that should have been discharged by a business enterprise. Its meaning and content are synonymous with that of social responsibility accounting.

The concept has been under experiment for a number of years, but perhaps has not commanded the attention which it deserves. The measurement and methodology for the conduct of social audit are yet to be devised and developed.

The term ‘social audit’ is understood in different connotations by different men to include various practices, such as:

Inventory of ‘social programmes’ undertaken by a company.

Inventory of their ‘social impacts’.

Estimates in terms of money of various company activities having ‘special social significance’.

Results of surveys on environmental pollution, employment discrimination, occupational health and safety, etc., undertaken at the instance of the Government’s regulatory measures.

Critical report or surveys made on an area external to a company or industry, for example, sexual discrimination, caste discrimination, etc.

A general consensus of opinion is that the large-scale business houses have considerable social power in relation to pollution, landscape effects, community facilities and employment to minorities, etc., and that the society is increasingly becoming conscious about the social costs and benefits of corporate activity. Only recently, it has been thought of by a handful of corporate houses that a system of accounting for corporate social performance is needed.

Objectives of Social Audit:

Social audit may have three objectives basically:

1. To identify and measure the periodic net social contribution of an individual firm, which includes not only the costs and benefits internalized to the firm, but also those arising from externalities affecting different social segments;
2. To help determine whether an individual firm’s plans, strategies and practices that directly affect the relative resource and earnings are consistent with social principles;
3. To make available in an optimum manner to all social commitments, relevant information on a firm’s objectives, ultimate goals, policies, programmes, performances and contributions to the social goals. Relevant information is that which should provide for a scheme of public accountability and public decision—making regarding capital choices and social resources allocation.

Advantages of social audit

- (a) Trains the community on participatory local planning.
- (b) Encourages local democracy.
- (c) Encourages community participation.

- (d) Benefits disadvantaged groups.
- (e) Promotes collective decision making and sharing responsibilities.
- (f) Develops human resources and social capital

Social audit committees

Social audit can also be used for auditing the performance of all three PRI tiers with a social audit committee at each level. These committees should not be permanent, but can be set up depending on the nature of programmes/schemes to be audited.

Social audit committee members can be drawn from among programme stakeholders. It is advisable to use the services of retired functionaries of different organizations, teachers or persons of impeccable integrity living in the Zilla Panchayat/Block Panchayat/Gram Panchayat jurisdiction. Both facilitators and social audit committee members can be trained by social audit experts.

Steps in social audit in local bodies

1. Clarity of purpose and goal of the local elected body.
2. Identify stakeholders with a focus on their specific roles and duties. Social auditing aims to ensure a say for all stakeholders. It is particularly important that marginalized social groups, which are normally excluded, have a say on local development issues and activities and have their views on the actual performance of local elected bodies.
3. Definition of performance indicators which must be understood and accepted by all. Indicator data must be collected by stakeholders on a regular basis.
4. Regular meetings to review and discuss data/information on performance indicators.
5. Follow-up of social audit meeting with the panchayat body reviewing stakeholders' actions, activities and viewpoints, making commitments on changes and agreeing on future action as recommended by the stakeholders.
6. Establishment of a group of trusted local people including elderly people, teachers and others who are committed and independent, to be involved in the verification and to judge if the decisions based upon social audit have been implemented.
7. The findings of the social audit should be shared with all local stakeholders. This encourages transparency and accountability. A report of the social audit meeting should be distributed for Gram Panchayat auditing. In addition, key decisions should be written on walls and boards and communicated orally.

Key factors for successful social audit

Level of information shared with and involvement of stakeholders, particularly of the rural poor, women, and other marginalized sections.

Commitment, seriousness and clear responsibilities for follow-up actions by elected members of the Gram Panchayat.

Involvement of key facilitators in the process.

Meaning and Definitions:

Cost Audit is a critical review undertaken to verify the correctness of Cost Accounts and to check that cost accounting principles and planning have been efficiently followed. It is noteworthy that India is the only country which has introduced statutory cost audit to regulate about 45 vital industries of the country. Cost Audit has been defined by the Chartered Institute of Management Accountants (CIMA) of London as —the verification of cost accounts and a check on the adherence to the cost accounting plan.‡

This definition implies the following:

- (i) The objects of cost accounting with reference to which the cost accounting plan must have been drawn up have to be kept in mind to see whether or not the plan itself and the figures collected will lead to the achievement of the goal or objective set. For instance, if the objective is to achieve maximum efficiency, the plan and the analysis of data will be different from the case where the only objective is to fix prices.
- (ii) It has to be examined whether the methods laid down for ascertaining costs and other relevant decisions are being implemented. Treatment and determination of abnormal losses of gains or treatment of certain expenses as direct or indirect are cases in point.
- (iii) The correctness of the figures has to be vouched.

—Statutory Cost Audit is a system of audit introduced by the Government of India for the review examination and appraisal of the cost accounting record and added information required to be maintained by specified industries‘ (ICWA of India).

The concept of cost audit has been elaborated by ICWA as —an audit of efficiency of minute details of expenditure, while the work is in progress and not a post mortem examination.

Financial audit is a —fait accompli‘, cost audit is mainly a preventive measure, a guide for management policy and decision in addition, to being a barometer of performance‘.

Cost Audit can be called efficiency audit. It is evidenced by amendment in section 209 which reads. _The object of the amendment of the section is to ensure specified company proper records relating to utilisation of material labour are available which would make efficiency audit (cost- audit) possible‘.

Management Auditing is the process of —auditing the quality of managers through appraising them as individual managers and appraising the quality of the total system of managing in an enterprise.¶ Thus management audit aims at assessing how managers perform different functions of management, e.g., planning, coordinating, motivating, etc.

Advantages of Cost Audit:

The chief advantage of a cost audit will be that management will be sure to get reliable data for its objectives — price fixing, decision-making, control, etc. Existence of such a system of audit will also be of great use for maintaining internal check and control and will be of great help to even financial audit. But it must be understood that the aims of financial and cost audit are different.

The former aims at prevention of frauds and errors and with presentation of Profit and Loss Account and Balance Sheet which exhibit a true and fair view of the state of affairs (of profit earned during the year and of financial position at the end of the year).

It is concerned with totality of expenditure and revenue rather than its functional analysis. Cost Audit will establish the accuracy of cost of each product, job, activity, etc., and is concerned with proper analysis of information and its estimation so that management gets the necessary information promptly. Apart from reliability of data, cost audit should afford certain incidental advantages. Rather, it should be said that cost audit will help consolidate and realize advantages expected from a system of costing. Following statement of the HR Gokhale Ex-minister of Law, Justice and Company Affairs emphasizes the social advantage of cost audit.

_The objective of this measure (cost audit) is to protect consumers from unwarranted increase in prices. Reasonableness of the prices charged can only be ensured by correct determination of costs and the margin charged by producers and their retailers. Another object underlying this step is to make the industries covered by such rules alert and efficient and also to make them know their rational cost with a view to reducing it to the extent possible. Thus by resorting to this method, the interest of consumer is safeguarded and it is definite step

towards removal of social injustice‘.

Types of Cost Audit:

The main types of Cost audit are the following:

(i) Cost Audit as an Aid to Management:

The aim is to see that all information placed before management is relevant, reliable and prompt so that management can discharge its duties well. It must also be seen that no relevant or pertinent information is suppressed.

(ii) Cost Audit on Behalf of a Customer:

Often contracts are placed on —Cost Plus basis. In other words, the customer will determine the final price to be paid on the basis of exact cost plus an agreed margin of profit. The customer, in such a case, usually gets cost accounts of the product concerned audited to establish correct cost and, therefore, price.

(iii) Cost Audit on Behalf of Government:

Sometimes the Government is approached with request for financial help or protection. Before taking a decision on the request, the Government may choose to get cost accounts of the applicant audited to establish whether the need for help is genuine or is a result of mere inefficiency.

(iv) Cost Audit under Statute:

The Amendment Act of 1965 has inserted a new section, 233B, in the Companies Act, 1956 whereby the Central Government may order that certain classes of companies will get their cost accounts audited by a member of the Institute of Cost and Works Accounts of India.

Only such companies as are required to maintain proper records regarding materials consumed, labour and other expenses under Section 209 (as amended to date) and may be required to get their cost accounts audited.

The powers and duties and manner of appointment of the cost auditor are the same as that of external financial auditor and the same disqualifications will apply. The cost auditor will submit his report to the Company Law Board with a copy to the company. The right to investigate all aspects of cost accounts is presumably granted to the cost auditor.

The aim of cost audit under statute seems to be that the Government wishes to know, as an instrument of control, the costs of various goods. Government has the power to prescribe the forms in which cost audit reports are to be made out. These are designed not only to verify

information, but also to convey good deal of information to Government.

(v) Cost Audit on Behalf of the Trade Association:

Sometimes trade associations seek to maintain prices at a certain level. For this purpose, the accuracy of costing information submitted by various concerns has to be checked. The trade associations may seek to have full information about production capacity and the relative efficiency of productive processes.

Advantages to Management:

- (i) Errors in following costing principles and techniques are detected. Inconsistencies and frauds can also be detected. This keeps everyone alert and promotes efficiency.
- (ii) Cost audit can serve to measure performance of managers and better performance can be rewarded.
- (iii) It helps to prepare accurate cost reports and this business planning can be more accurate.
- (iv) Inter-firm comparisons can be made with ease and this might be a very useful proposition if industrial intelligence is good.
- (v) Cost audit can give an idea about the comparative operational efficiency of each department or division; and may thus pin-point deficiencies and also encourage to operate in a competitive spirit.

Advantages to Management/Cost Accountant:

Important advantages are:

- (i) His task is facilitated since errors, deficiencies, etc., are pointed out. Costing plans can be prepared to take care of these things.
- (ii) Cost audit may help in easier reconciliation of cost and financial accounts.
- (iii) If the cost auditor is an outsider and is an expert, he can certainly give some practical and sound advice to streamline costing systems and organisation.
- (iv) Cost audit helps to focus attention of management on the problems faced by the cost accountant. This helps him to realize his goals and objectives with ease.

Advantages to Statutory Auditor:

Important advantages are:

- (i) Audited cost data helps him to determine the value of stocks, remuneration of managerial personnel, etc., with ease and accuracy.
- (ii) Data and statements of cost audit help him to prepare his audit programme and plan so

that he concentrates more on those aspects which have not been adequately covered by cost audit.

Advantages to Consumers:

- (i) The direct benefit accrues where a statutory cost audit has been done to fix a reasonable price for the consumers.
- (ii) Since cost audit aims at ensuring efficiency in the organisation, this may also get reflected in reduced prices to the consumers.

Advantages to Labour:

- (i) If cost audit is done thoroughly labour also stands to gain through increased profitability in the shape of bonus and other benefits.
- (ii) Also it brings into focus the role of labour in improving efficiency in term of increased productivity.

Advantages to Shareholders:

- (i) There is correct valuation of all kinds of inventories. This may project a true picture of the organisation before shareholders and other investors and help them to assess its performance.
- (ii) External cost audit highlights efficiency or inefficiency, utilisation of manpower and other resources, adequacy of return, etc.

Advantages to Government and Economy:

- (i) It helps the government to settle accounts where cost-plus contracts have been made.
- (ii) The government can intervene to protect the interests of the consumers, labour, shareholders and investors from exploit-age or inefficient managements.
- (iii) At the national level, cost audit promotes cost consciousness and overall efficiency. This means that every rupee invested produces the maximum quantity of goods and services.

Definition

Performance auditing has been variously defined. A working definition is as follows: "Performance auditing is an assessment of the activities of an organisation to see if the resources are being managed with due regard for economy, efficiency and effectiveness and accountability requirements are being met reasonably."

In this definition the key words are:

- a. assessment
- b. activities
- c. organisation
- d. resources
- e. management

f. economy

g. efficiency

h. effectiveness

i. accountability requirements

j. reasonability

a. **Assessment:** It means that the auditor formulates a judgement on the basis of relevant and reliable evidence. The judgement may contain a certain amount of subjectivity and hence may be contested by the auditee management. But to the extent it is based on agreed facts and is arrived at after carrying out generally accepted auditing procedures it is treated as valid.

b. **Activities:** Performance auditing extends to financial as well as non-financial activities of an organisation. It reviews the main operations of the organisation. Obviously, it implies that auditors would require some understanding of technical operations of the auditee. This may necessitate association of social or physical scientists or other specialists with the auditors.

c. **Organisation:** Performance auditing takes an over view of the activities and functions of an organisation as a whole. In exceptional cases, it may review an isolated project or a programme as well. But for generalised conclusions it is necessary that the organisation is reviewed as a whole in its operational environment.

d. **Resources:** The resources of an organisation consist of money, men, materials, and machines. Performance auditing reviews all these resources.

e. **Management:** Management covers such functions as planning, organisation, resourcing, directing and controlling. Performance auditing reviews all these phases of management cycle. It is not concerned merely with the 'use' of resources.

f. **Economy:** Review of economy is a primary element in performance auditing. Economy means acquiring resources at the lowest cost keeping in view the objectives of the organisation.

g. **Efficiency:** Efficiency refers to the relationship of inputs and outputs. It relates to utilisation of resource.

h. **Effectiveness:** It means the extent to which an organisation achieves its objectives.

i. **Accountability requirements:** Public managers are responsible to carry out the policies of the legislature by translating them into appropriate programmes. Certain resources are provided to them to implement these programmes. They are expected to report back to the legislature about the results of their programmes. Traditionally, the

report to the legislature is presented in the form of appropriation accounts, which is, as a matter of fact, a report of the financial results. With increased emphasis on receiving value for money and reducing waste in public spending, more and more legislatures are demanding reports on operations of government departments and agencies. The Supreme Audit Institutions have been authorised in a number of countries to report on the economy, efficiency and effectiveness of government operations. The report of the Supreme Audit Institutions comments on the adequacy of the executive department reports, so far as accountability requirements are concerned. It informs the legislature whether the reports of the executive operations provide a complete and satisfactory explanation of the results achieved, keeping in view the resources available to them. Where the reports of the executive are incomplete, ambiguous or unsatisfactory, the audit report makes a mention of it. Thus performance auditing acts as a catalyst to increase awareness of accountability among public managers.

j. Reasonability: The performance auditing adopts the approach of a reasonable manager. It does not turn an oblique eye to the constraints of the management. Instead it takes into account the total environment in which executive departments operate. It does not base its judgement on hind-sight wisdom.

Performance Measures for effectiveness

Appropriate performance measures to assess the effectiveness of projects are very difficult to devise. There are three main problems:

- a. Problem of jointness: Where a number of different policies may contribute to satisfying unmet needs. For example, educational standards may be affected by the size of classes, the quality of teachers and the supply of equipment. It may be very difficult in practice to analyse the effect of individual policies.
- b. External factors: Sometimes factors outside the control of the management affect the outcome of a project or programme. For example, income and social status of the consumers.
- c. Cost: Sometimes programmes cannot be carried out in the most effective manner due to prohibitive cost. For example, it may be more effective to have more teachers than to provide more books. But the cost of the former may be prohibitively high.

Because of these difficulties in the measurement of effectiveness the auditor should move cautiously. The best method should be to devise performance indicators in consultation with the management. But the auditor should keep in view any national or international standards

already available. Similarly, the objectives laid down in the plan may be taken as a benchmark for some of the outcomes. In no case should the auditor restrict his audit criteria to the original plan only.

Sources of Performance Measures: There are a number of sources of effectiveness measures, such as following:

a. Citizen surveys,,: especially in areas of social services, police, garbage collection etc.

For reliable results, extreme care need be exercised in determining sample size and preparing questionnaires.

b. Trained observer ratings: Trained observers are used to rate conditions in a particular area, using pre-designated rating criteria such as street cleaning.

c. Industry standards: Comparison of the results of a programme with prevalent standards in that area or with other similar programmes.

d. Internal records: Review of internal records such as occupancy rate for residential homes, user complaints, etc. sometimes provides vital information for measuring' effectiveness.

Normally, the auditor is not expected to carry out the above exercise himself. His primary duty is to see if the auditee has a reliable system to evaluate its own effectiveness. In that case, he would focus his attention on the adequacy of these procedures. In case the auditee does not have a reliable mechanism to measure its own effectiveness the auditor may have to do it himself.

The main focus of effectiveness auditing is on the assessment of the extent to which an agency failed to attain the intended goals. But a simple explanation of possible reasons for shortfall in achievement of goals is not enough. For example, it is not enough to say that the agency could not achieve its goals because of cost over run or time over-run. Instead it is necessary that the auditor should analyse the reasons into following two categories.

a. Factors that could have been influenced by the agency. They would emerge from an answer to the question: did the agency perform its task in the most appropriate way, seen in relation to the assignment that it intended to carry out?

b. Factors that could not be influenced by the agency such as Government policy, applicable rules, socio political environment, appropriation of funds and availability of trained manpower, etc.

Technical Guide on Audit in Hotel Industry

India is fortunate to have a domestic market that supports the growth of the travel industry even when the world economy is experiencing a downturn. However, domestic travel has

probably never been given its due. Even today, it is the statistics on the foreign travellers that garner attention; though, it is the less represented domestic segment that forms the major component of

revenue generated by the Indian travel industry.

The domestic demand for hotels in India has historically been higher than the demand from foreigners. Though a large portion of domestic demand originates from commercial activity, an increasing number of Indians are taking annual holidays, both within the country and overseas. Many States within India such as Kerala, Rajasthan, Goa have started focusing their efforts on the Indian traveller.

The current count of hotel rooms in India is 130,000, and the country is expected to require an additional 50,000 rooms over the next two to three years, according to World Travel and Tourism Committee (WTCC) estimates.

The World Travel and Tourism Council (WTTC) has predicted that India has the potential to become the number one tourist destination in the world with the demand growing at 10.1 per cent per annum and will receive 25 million tourists by the year 2015.

Other than hotels, there are lots of standalone restaurants which are also contributing to economic activity and there are branded chains of restaurants which are claiming prominence across India. Similarly, standalone SPA, medical tourism, etc., are driving the demand and need for expansion of hotel room requirements.

Factors affecting Hotel Industry

There are various factors which affect the growth of the Hotel industry, viz., economic, political, competition, substitutes, strength of suppliers and of course employees.

Economic Factors

Various key economic factors like interest rates, taxation changes, economic growth, inflation and exchange rates affect the Hotel industry as much as any other business. However, even global recession which has even though not affected India much had major impact in hotels as foreign tourist arrival dropped considerably. Hence, economic circumstances of not only India

but global economic factors also affect the industry performance. This phenomenon has been witnessed even in the past like during the 1997 Asian economic crisis.

Political factors

Political stability in the country is considered important for the growth of any industry in the country. The political stability is even more necessary for the growth of Hotel industry. In the past Afghan war, Mumbai terror attacks, etc., have forced foreign countries to bring in

travel adversaries which poorly affected the Hotel industry.

Competition

Competition drives both the supply of the rooms and also creates demand for rooms through advertisements by competitors. Whereas competition leads to reduction in prices in the short run, it also leads to improvement in quality of service / product and also bring in healthier impact in the Industry by forcing players to reposition the brand / quality of service in the long run.

Substitutes

Of late due, to ever raising room rates especially in five star Hotels category, lots of substitutes have emerged to cater to travellers who spend considerable amounts on Hotel stays. For instance, video conferencing has obviated the need for businessmen to travel long distances, stay in hotels and have face-to-face meetings. Similarly, most corporates have started using own guesthouses / shared service apartments resulting in reduction in the Hotel capacity.

Strength of Suppliers

The existence of reliable sources that could provide timely high quality goods and services at competitive rates, is a very important factor for growth of the Hotel industry. The existence of such sources is of even greater necessity for purchase of perishable goods that need to be procured on a daily basis. In the scenario where outsourcing of certain services (like back of the housecleaning services, Kitchen Stewarding) is gaining wider acceptance for the purpose of converting fixed overheads into variable overheads, the strength of suppliers in terms of their ability to provide consistently timely services, assumes great significance.

Employees

Employees are always considered as the key asset in a service-oriented industry. The quality and competence of employees, not only of those who interact directly with the guests but also of those who provide support services, are critical to the success of a hotel. Ever increasing employee cost also results in reduction in manpower. Hotels in India in the past had operated with an average of 2, and in some cases, 3 employees per room as compared to the international benchmark of 1.5 or less employees per room.