

# INTRODUCTION TO AUDIT

## 1. Objectives:

The document is intended to:

1. understand the definition of audit and audit control;
2. list out the objectives of audit;
3. narrate the functions and spirit of audit;
4. list out different types of audit and the process of audit;
5. narrate the systems of audit.

## 2. Introduction:

Audit was originally confined to ascertaining whether the accounting party had properly accounted for all receipts and payments on behalf of his principal, and was in fact merely a cash audit. Modern audit not only examine cash transactions, but also verify the purport to which the cash transactions relate.

### **2.1. Audit**

Audit is, therefore, an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they purport to relate.

### **2.2. Audit an agency of Financial control**

Audit is an instrument of financial control. In its relation to commercial transactions, it acts as a safeguard on behalf of the proprietor against extravagance, carelessness or fraud on the part of proprietors' agents or servants in the realization and utilization of his money or other assets and it ensures on the proprietors behalf that the accounts maintained truly represent facts, and that expenditure has

been incurred with due regularity and propriety.. The agency employed for this purpose is called 'an auditor'.

### **2.3. Government auditing**

Audit forms an indispensable part of the financial administration and is one of the important organs necessary to ensure the sound functioning of a Parliamentary Democracy. It is the main instrument to secure accountability of the Executive to the Legislature. Audit assists Parliament/Legislature in exercising its financial control over the Executive, to ensure that funds voted by the Parliament/Legislature have been utilized for the purpose intended and the funds authorized to be raised through taxation and other measures have been assessed, collected and credited to the Government properly.

The primary function of audit is to verify the accuracy and completeness of accounts to secure that all revenue and receipts collected are brought to account under the proper head, that all expenditure and disbursements are authorized, vouched and correctly classified and the final account represents a complete and a true statement of the financial transactions it purports to exhibit. It is the function of audit to verify that financial rules and orders satisfy the provisions of Law and or otherwise free audit objections and the rules & orders are properly applied.

### **2.4. Audit control**

Para 3.4 of Intro. Accts & audit

State Audit is the main instrument to secure accountability of the lower formation in the set up to the Administration and of the Administration to the Legislature in the area of financial administration. The scope of State Audit encompasses following elements:

#### **2.4.1. Fiscal accountability**

This includes fiscal integrity, full disclosure and compliance with applicable laws and regulations.

#### **2.4.2. Managerial accountability**

It is concerned with efficiency and economy in the use of public funds, property, personal and other resources.

#### **2.4.3. Programme accountability**

To check whether Government programmes and activities are achieving the objective established for them with due regard to both costs and results.

### **3. Objects of audit**

Overall objectives of audit are aimed:

- a) To detect error and fraud in accounts
- b) To prevent commission of errors and frauds
- c) To enable timely finalization of accounts
- d) To make know the public that the state of affairs of the Institution

To achieve the above objectives in respect of Government audit, it has to be ensured that:

Para 6.17 of Intro. Accts & audit

- (i) There is provision of funds for the expenditure duly authorized by a competent authority.
- (ii) The expenditure is in accordance with a sanction properly accorded and is incurred by an officer competent to incur it.
- (iii) Payment has been made to proper person and duly acknowledged so that a second claim on the same account is impossible.
- (iv) The charge is correctly classified.
- (v) In the case of audit of receipts (1) the sums due are regularly recovered and checked against demand and (2) sums received are duly brought to credit in the accounts.
- (vi) In the case of audit of stores and stock where a priced account is maintained stores are priced with reasonable accuracy and rates fixed are reviewed from time to time.
- (vii) That the numerical balance of stock materials is reconciled with the total of value of balance in accounts.

- (viii) Expenditure conforms to the following general principles of standards financial property viz:
- (1) the expenditure is not prima-facie more than the occasion demands and that every Government servant exercises vigilance in respect of expenditure as his own money;
  - (2) no authority exercises its power of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage;
  - (3) public moneys are not utilized for the benefit of a particular person or section of community unless:
    - a) the amount of expenditure involved is insignificant or;
    - b) the expenditure are in pursuance of a recognized policy or custom and
    - c) the amounts of allowance such as traveling allowance are not on the whole a source of profit to the recipients.

#### 4. Function and spirit of Audit

Audit forms an indispensable part of the financial system and is one of the important organs necessary to ensure the sound functioning of a parliamentary democracy. It is the main instrument to secure accountability of the executive to the Legislature.

##### **4.1. Functions of Audit**

Para 15.2 of Intro. Accts & audit

The primary function of Audit is to verify the accuracy and completeness of accounts, to secure that all revenue and receipts collected are brought to account under the proper head, that all expenditure & disbursement are authorized, vouched and correctly classified and the final account represent a complete and true statement of the financial transactions it purport the exhibit. Its broad aim is to safeguard the financial interest of the taxpayer.

##### **4.2. Spirit of Audit**

Para 15.5 of Intro. Accts & audit

In audit under insistence on trifling errors and technical irregularities which are of no consequence to the finances of the Government should wherever possible be avoided and more time and

attention devoted to the investigation of really important and substantial irregularities with the object not only on securing rectification of particular irregularity but also ensuring regularity and propriety in similar cases for the future.

## 5. Types of audit and process of audit

The officer incurring expenditure must follow some criteria fixed for payment. Essentials conditions for incurring expenditure are:

- (i) there should exist sanction either special or general, accorded by a competent authority, authorising the expenditure;
- (ii) there should be provision of funds authorised by competent authority fixing the limits within which the expenditure can be incurred;
- (iii) the expenditure incurred should confirm the relevant provisions of the Constitution and of the laws made thereunder and should also be in accordance with the financial rules and regulations framed by competent authority;
- (iv) the expenditure should be incurred with due regard to broad and general principles of financial propriety.

Different types of audit and the process involved in the respective audit are described below.

### 5.1. Appropriation Audit

Para 20.14 of Intro. Accts & audit

"Appropriation Audit" is directed primarily to ascertaining that the money expended has been applied to the purposes/purposes for which the grants and appropriations specified in the Schedule to an Appropriation Act passed under Art. 204 of the Constitution have been provided and that the amount of expenditure against each grants of

appropriation does not exceed the amount included in that Schedule. Audit has to satisfy itself that the expenditure which is being audited falls within the scope of a grant or an appropriation specified in the Schedule to the Appropriation. Expenditure in excess of the amount of a grant or appropriation as well as expenditure not falling within the scope or intention of any grant or appropriation unless regularized as laid in Art 205 of the Constitution should be treated as 'unauthorized expenditure'.

The responsibility for watching the progress of expenditure against a grant or appropriation devolves on the departmental officer, who ultimately responsible for keeping the expenditure within the grant or appropriation. Audit will render necessary help to the Executive in the matter and should see that suitable and adequate arrangements exist in all Departments of the Government for the control of expenditure. The Departmental Officer as well as the Accountant 'General should keep necessary registers to watch the progress of expenditure against each Unit of Appropriation. The detailed appropriation audit is conducted in two stages.

Para 20.17 of Intro. Accts & audit

- i) Sanction Audit ie. Audit of Orders of allotment funds and re-appropriations which are to be enforced in audit and
- ii) Audit of expenditure, against allotment

In the Audit of Order of allotment of fund and representation orders, it should be seen that:

- i) orders have been issued by a competent authority
- ii) the allotments made are not in excess of the amount available under the grant
- iii) the amount re-appropriated is available under the Unit from which it is allotted
- iv) the amount re-appropriated is not for meeting expenditure on a new service
- v) no amount is re-appropriated from one grant to another grant

- vi) no amount is re-appropriated from one charged to Voted and vice-versa
- vii) no funds provided under Plan Heads are re-appropriated to Non-Plan Heads without the previous consent of the Ministry of Finance.

## **5.2. Audit against Regularity**

Audit against Regularity consists in verifying that expenditure conforms to the authority which governs it to the relevant provisions of the Constitution and of the laws and rules made there under and is also in accordance with the Financial Rules, Regulations and orders issued by a competent authority. The Financial Rules Regulations and orders against which audit is conducted mainly fall under the following categories.

Para 16.02 of Intro. Accts & audit

- i) Rules and orders relating to the powers to sanction and to incur expenditure from the consolidated Fund and the Contingency Fund.
- ii) Rules and orders relating to the mode of presentation of claim against the Government from the Consolidated Fund. Contingency Fund and Public Account and in General the financial rules prescribing the detailed procedure to be followed by Government servant in dealing with Government transactions and
- iii) Rules and orders regulating the pay and allowances, pension and other conditions of service of Government servants.

The work of audit in relation to Regulatory of expenditure is of quasi-judicial character. It involves interpretation of the Constitution, statutes, Rules and Orders with reference to Case Laws of previous decisions and procedures. During the process of audit it should be seen that the rules and orders are not in-consistent with any provisions of the constitution or of the laws made thereunder, they do not conflict with the orders and rules made by any higher authorities, the issuing authorities has got the necessary powers. All orders relating to delegation of powers should be scrutinized to see whether they are in

order. The Comptroller and Auditor General does not possess the final power to interpret the Constitution status and of the Rules made by Government. The interpretation by audit should be based on plain meaning of the provisions and the judgement of the Supreme Court/High Court.

### **5.3. Audit against Propriety**

It is an essential and inherent function of audit to bring to light not only cases of clear irregularities, but also every matter which appears to involve improper expenditure or waste of public money or stores, even though the accounts themselves may be in order and no obvious irregularity has occurred. Such audit is called 'Propriety Audit'. Propriety Audit extends beyond the formality of the expenditure to its wisdom, faithfulness and economy. It is to be ensured that broad principles of orthodox finance are borne in mind. No precise rules can be laid down for regulating the course of audit against propriety. Its object is to support a reasonably high standard of public financial morality of sound financial administration and of devotion to the financial interests of Government. For eg. there will be sanction issued by competent authority for the purchase of pumpsets to farmers. There will be budget provision. Even then it may happen that there will not be any adequate supply of power in that area, thereby rendering the pumpset idle.

Para 16.17 of Intro. Accts & audit

Briefly the spirit which should animate propriety audit is explained as below:

In place of examination of authorities and rule, the work should be conducted with greater regard to the broad principles of legitimate public finance. Audit will not only see whether there is quoted authority for expenditure but also investigate the necessity for it. It will



ask whether individual item were in pursuance of the scheme for which the budget provided, whether the same results could have been obtained with greater economy, whether the rate and scale of expenditure were justified in the circumstances.

#### **5.4. Audit of sanctions to Expenditure**

The power to sanction expenditure from the Consolidated Fund and the Contingency Fund of a State is vested in the Governor of the State. The sanction of the Governor or of Fund of the State. One of the important functions of audit in relation to the audit of expenditure is to see that each item of expenditure its governed by the sanction of the authority competent to sanction. In the audit of sanctions against expenditure, audit is to see that the authority sanctioning it is competent to do so by virtue of powers vested in it or by the provisions of the Constitution and the laws. rules and orders made thereunder. Audit should also see that the sanction is finite and needs no reference to the sanctioning authority or to any higher authority. While conducting audit of sanctions against expenditure, audit should follow the guiding principles mentioned below:

Para 20.08 of Intro. Accts & audit

- 1) The sanctioning authority is vested with full powers in respect of certain class of expenditure. A sanction accorded under this power can be challenged by audit on the grounds of propriety.
- 2) If it is vested with powers which may be exercised provided due regard is paid to certain criteria which are expressed in general form, sanction accorded under this power can be challenged by audit.
  - i) if the disregard of the criteria is considered to be so serious as to make the sanction perverse or if the
  - ii) facts of the case are such as to make the audit confident that one or more of the criteria have been disregarded/
  - iii) for the purpose of financial sanction, a group of works which form one project will be considered as one work

and the necessity for obtaining the sanction of a higher authority is not avoided by reason of the fact that cost each particular work in the project does not require such sanction.

Besides the question of competency of the authority sanctioning the expenditure, the scrutiny of sanction should include the following points.

- i) whether the expenditure is a legitimate charge on the provision from which it is proposed to be met.
- ii) whether the expenditure conforms to the statutory provisions as well as the relevant financial rules regulations and orders
- iii) whether it fulfils the standards of financial propriety.
- iv) whether in the case of sanctions to new schemes of expenditure a satisfactory procedure of accounting has been prescribed and the detailed cost, time schedule, physical target and other objects of expenditure are duly laid down by the sanctioning authority.

All sanctions to expenditure should be noted and properly attested in the audit register against which the audit of expenditure will be conducted. Recurring charges which are payable on the fulfillment of certain conditions should be admitted in audit on receipt of a certificate from the drawing officer to the effect that conditions have been fulfilled.

### **5.5. Efficiency-cum-Performance Audit**

Para 17.01 of Intro. Accts & audit

Before independence, Government audit was mostly confined to check individuals, transaction against provision of funds, rules or orders or sanction or propriety of expenditure. These methods are quite effective and fruitful in detecting improper, irregular, extravagant wasteful and uneconomic expenditure. But after independence, the pattern of Government expenditure, its nature and dimension underwent rapid change in the wake of increasing Government expenditure on development and welfare activities. The security of individual transaction was felt quite inadequate. It become necessary and essential for audit to ascertain whether the various department

programmes and accordingly been developed to meet the changing requirements. This audit involves review of performance of a scheme in terms of the goals and objectives. Economy is the practical systematic management of the affairs of a scheme of project with minimum operating cost for carrying out its functions and responsibilities.

#### **5.5.1. Efficiency**

Efficiency is the accomplishment of assigned goals, production targets or other specific programmes, objectives in a systematic manner with minimum operating cost without detracting from the level, quality or timing of the services to be provided.

#### **5.5.2. Effectiveness**

Effectiveness is the adoption of a course of action which assures achievement of objects at the lowest reasonable cost and in a practical manner within an agreed time frame.

#### **5.5.3. Processing the review**

Para 17.04 of Intro. Accts & audit

In processing the review, the following stages are involved:

- 1) Preliminary study of the selected project scheme
- 2) Development of Audit Plan
- 3) Review proper
- 4) Preparing the review report

##### **5.5.3.1. Preliminary study of the selected project scheme**

The preliminary study of a scheme is aimed at having a comprehensive insight in the broad picture obtained at the time of selection of scheme, to locate areas/aspects requiring an in-depth examination, Act, rules and regulations, budget and plan of documents, performance budget of the department, progress reports, administrative reports, periodical appraisals, reports by Departmental and External Agencies like Planning Commission, Public Accounts Committee. Estimates Committees etc. would

provide the necessary background materials for carrying out his study. Such study helps in understanding the ideas of the scheme, its objectives financial targets and expenditure, the agencies executing the scheme. During the preliminary study, it should be see:

- (i) whether adequate surveys have been conducted before launching the scheme
- (ii) whether proper feasibility report was prepared
- (iii) whether there is detailed project report and if there are deviations why this deviations have taken place
- (iv) whether there is effective system of material management
- (v) what contracting system have been laid down
- (vi) what are the operational problems and how they are got over

#### **5.5.3.2. Development of Audit Plan**

Para 17.07 of Intro. Accts & audit

A specific audit plan is chalked out in advance indicating the guidelines for investigation marking out the offices to be visited and the time allotted for completing the review. Necessary format and questionnaire are also prepared for collection of important data relating to the various aspects of the scheme from the field offices.

#### **5.5.3.3. Review proper**

Para 17.08 of Intro. Accts & audit

The approach of audit is systematic methodical, logical and rational. The review always commences with an in-depth study of files in the offices in the concerned administrative department and heads of department. While scrutinizing the records, audit is to see whether

- 1) the objectives of the project have been well defined and are in conformity with the accepted policies and decisions of the Government
- 2) programmes have been drawn up in accordance with these objectives and are being implemented by specific and well defined procedures
- 3) a good monitoring/management information system exists for collecting reliable data and whether the date is

effectively utilized to improve organization or remedial deficiencies with utmost speed.

The next stage is carrying out the studies and collecting information from selection units. The examination and audit scrutiny of selected samples should be thorough and complete. To elicit maximum information it is useful to discuss details of the projects/scheme with the officers of the institutions visited.

The review work involves indepth study of the projects, programmes, organisational set up, managerial process, checks and control, research and development personal policies and management, material management budget and accounts.

#### **5.5.3.4. Preparing the review report**

This is the final stage of the review. The data collected from the departmental offices are consolidated for interpretation and detailed analysis. By careful detailed and analytical dissection of this findings of investigation made at different stages the review report is prepared highlighting major irregularities like non-realisation of social and economic objectives, non-observance of time schedule, over capitalisation, over staffing, idling personnel, work back logs, delays in connection of projects, resulting in increase of expenditure, absence of trained manpower, plants operating below rated capacity, excessive inventories, absence of sound pricing policy, unauthorised occupation of Government lands, leakage of revenue, overpayment, improper avoidable and infructuous expenditure etc.

## 6. Systems of Audit

The system of audit can be broadly classified into two viz. central audit and local audit.

## **6.1. Central Audit**

The systems of Central audit is confined to the offices of Accountant General (Audit) located in the State Capital. Central Audit is based on the Accounts, vouchers schedules and other documents submitted to him by various disbursing authorities like the Treasuries, PW Divisions, Forest Divisions as also the copies of sanction endorsed to the AG's by the various sanctioning authorities. The following are the duties and functions carried out in Central Audit.

- a) Audit of sanction and agreements
  - b) Audit of vouchers and monthly accounts
  - c) Recording of the objections in the objection book and issue of the objection memos and pursuance with the concerned departments
  - d) Scrutiny and certification of finance and appropriation accounts
- Central Audit is by and large regularity and propriety.

## **6.2. Local Audit Inspection**

Para 18.01 of Intro. Accts & audit

The major portion of the original records namely the initial accounts and other books or papers on which the accounts so rendered are based are retained in the offices where they originate. To enable him to assure himself of the accuracy of the original data on which the accounts and his audit work are based, the Accountant General has authority to inspect any offices of Accounts which is under the control of the State Government including treasuries and such offices responsible for the keeping of initial or subsidiary accounts. The object of local audit is to audit the initial or subsidiary accounts. The object of local audit is to audit the initial accounts maintained properly, the financial rules are properly observed, whether the accounts are accurate and complete according to the prescribed rules for the audit of expenditure and receipts of the Government.

The results of the local audit are set forth in two separate documents:

- 1) Inspection report dealing the more important defects of procedures and financial irregularities and describing brief the general state of the accounts.
- 2) Test Audit Note dealing with error of minor irregularities which are not important enough to be brought to the notice of higher authority.

## 7. Conclusion

This article gives introductory details relating to audit conveying an overall idea of Government audit. Main points as described in the document are:

1. Definition of audit giving overall importance to Government audit and audit control.
2. Details relating to objectives and functions of audit.
3. Different types of audit and specialties in each case.
4. The systems of audit existing in the Government set up.