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Types of Audits: A Comparative Analysis

Knowledge Series

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❖ Introduction

Auditing, a critical component of financial oversight, plays a pivotal role in ensuring the accuracy, reliability, and compliance of an organization's financial statements. However, the auditing landscape is diverse, encompassing various types of audits, each with its distinct purpose and scope.

This comparative analysis delves into the intricacies of different types of audits, shedding light on their objectives, methodologies, and applicability.

From the rigorous scrutiny of statutory audits to the internal assessments of internal audits, this exploration will provide a comprehensive overview of the auditing landscape. By examining the similarities and differences between these audit types, we aim to equip readers with a deeper understanding of their roles in safeguarding financial integrity and promoting transparency.

❖ Meaning of Audit?

An audit is a systematic examination of an organization's financial records, statements, and operations to assess their accuracy, reliability, and compliance with relevant laws, regulations, and standards. It involves a thorough review of financial transactions, internal controls, and governance practices to provide an independent and objective evaluation.

Audits serve as a valuable tool for ensuring accountability, detecting fraud, and identifying areas for improvement. They can be conducted by internal auditors employed by the organization itself, external auditors hired from independent firms, or regulatory bodies.

❖ Types of Audits

The auditing landscape is diverse, encompassing various types of audits, each with its distinct purpose and scope. This comparative analysis will delve into the intricacies of five key types of audits:

a. Statutory Audit
b. Internal Audit
c. Tax Audit
d. GST Annual Returns
e. Transfer Pricing Audit

In this series, we will explore the objectives, methodologies, and applicability of these audit types, providing a comprehensive understanding of their roles in ensuring financial integrity and compliance.

❖ Statutory Audit

The term statutory denotes that the audit is required by statute. A statute is a law or regulation enacted by the legislative branch of the organization’s associated government.

A statutory audit is a legally required examination of a company’s financial records and statements to ensure compliance with applicable laws and regulations. Statutory audits are essential for enhancing transparency, maintaining financial credibility, and safeguarding stakeholders’ interests.

A statutory audit, also known as an external audit or financial audit, is a comprehensive examination of a company’s financial records, transactions, and statements by an independent auditor. The purpose of this audit is to determine whether the financial statements present a true and fair view of the company’s financial position and performance, in accordance with the applicable accounting standards and regulatory requirements. The auditor issues an opinion on the financial statements, providing assurance to stakeholders about their reliability and accuracy.

There are different types of audits carried out during a statutory audit. Let’s explore a few common ones:

1. **Financial Statement Audit:** This type of audit focuses on verifying the accuracy and completeness of a company’s financial statements. It involves inspecting supporting documents, conducting tests, and assessing internal controls.
2. **Operational Audit:** An operational audit evaluates the efficiency and effectiveness of a company’s operational processes, systems, and management. It aims to identify areas for improvement and cost-saving measures.
3. **Compliance Audit:** Compliance audits ensure that a company adheres to specific laws, regulations, and industry standards relevant to its operations. For example, a compliance audit may involve assessing a company’s tax compliance or adherence to environmental regulations.
4. **Information Systems Audit:** Information systems audits evaluate the reliability, security, and integrity of a company’s information systems, including data handling processes, network security, and data backups.

5. **Internal Financial Controls Audit (IFC Audit):** Under the Companies Act 2013, every company is required to have an effective system of internal financial controls to ensure that its financial statements are accurate and reliable, and to prevent fraud and mismanagement. Considering importance of internal financial controls over financial reporting, IFC audit is also a key area covered under internal audits.

All companies, regardless of their size, nature of business or industry, are required to have an adequate system of internal financial controls in place to ensure the reliability of their financial statements, prevent fraud and mismanagement, and ensure compliance with applicable laws and regulations.

As per provisions of Section 143(3)(i) of Companies Act,2013 the Auditor Report shall state whether the Company has adequate IFCs with reference to financial statements in place and the operating effectiveness of such controls.

MCA vide its notification dated 13th June 2017 [G.S.R. 583(E)] amended the notification of the Government of India, In the ministry of corporate of affair, vide no G.S.R. 464(E) dated 05th June 2015 providing exemption from IFCs to following private companies:

1. Which is one person Company (OPC) or a Small Company; or
2. Which has turnover less than Rs. 50 Crores as per latest audited financial statement and which has aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less then Rs. 25 Crore.

The above exemption shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 of the CA 2013 or annual return under section 92 of CA 2013 with the Registrar.

It is important to note that the applicability of internal financial controls is not limited to the Companies Act 2013. Companies may also be subject to internal control requirements under other laws and regulations, such as tax laws, securities laws, and banking regulations. Therefore, companies should ensure that they have an adequate system of internal financial controls in place to comply with all applicable laws and regulations.

The reporting by the auditor is dependent on the underlying criteria for internal financial controls over financial reporting adopted by the management. However, any system of internal controls provides only a reasonable assurance on achievement of the objectives for which it has been established.

❖ Internal Audit

Internal audit is an independent function involving continuous and critical appraisal of the functioning of an organization with a view to suggest improvements thereto and add value to the governance mechanism of the organization. It helps the organization to evaluate the effectiveness of risk management and internal control implemented and provides recommendation for improvement.

Applicability of Internal audit

The Companies Act, 2013 along with Rule 13 of the companies Rules, 2014 specify which companies are to undertake internal audits. The following entities must comply with Section 138:

Extract of rule 13 of Companies (Accounts) Rules, 2014

S no.	Company's type	Applicability or Criteria
1	Listed Companies	All Companies listed on stock exhanges in india must have an internal auditor.
2	Unlisted Public companies	Turnover - 200 crores or more
		Paid up share capital - 50 crores or more
		Outstanding loans/borrowings from banks or financial institutes - Exceeding limit of 100 crores or more
		Outstanding deposits - 25 crores or more
3	Private Companies	Turnover - 200 crores or more
		Outstanding loans/borrowings from banks or financial institutes - Exceeding limit of 100 crores or more

Qualifications for Internal Auditors

The Companies Act, 2013, section 138 (1) specifies the qualifications of internal auditors. Companies appoint persons competent to conduct internal audits.

The following professionals are eligible to become internal auditors:

a. **Chartered Accountants:** Those with a chartered accountant qualification – practicing or not.

b. **Cost Accountants:** Persons certified as cost accountants, with or without practical experience.

c. **Other Professionals:** The board might also appoint other professionals suited for the role.

It should be noted that the statutory auditor can't be appointed the internal auditor of the same company under Section 144 (b) of the Companies Act, 2013. This clause guarantees the independence of internal auditors and stays away from conflicts of interest.
Key Areas of Focus for Internal Audit

Internal audits usually deal with areas including:

- **Risk Management:** Assessing the company's risk management framework and identifying possible risks.
- **Internal Controls:** Evaluating the effectiveness of internal controls for protecting assets and for making accurate financial reporting.
- **Compliance:** Conformity with regulatory and statutory requirements within the business.
- **Operational Efficiency:** Continually reviewing operational processes to identify improvement opportunities and cost savings.
- **Financial Accuracy:** Verification of financial records and reports.

Various types of Internal Audits

Internal audits are generally of several kinds concentrating on different facets of the business's compliance and operations. An illustrative list is given below.

- **Financial Audit** – Addresses questions of accounting, recording and reporting of financial transactions as well as reviewing the adequacy of internal controls.
- **Compliance Audit** – Ensures compliance with all regulatory and statutory requirements.
- **Operational Audit** – Evaluates the performance and efficiency of different operations in the business.
- **Technology Audit** – Looks at the company's technology infrastructure – ensuring it is safe, effective and up to date.
- **Management Audit** – Assesses company's organizational structure and working procedures.
- **Environmental Audit** – Environmental audits evaluate the company's environmental impact and then confirm compliance with environmental standards. These audits help the company to be sustainable and lower their environmental footprint.

❖ Tax Audit

Tax audit is an examination or review of accounts of any business or profession carried out by taxpayers from an income tax viewpoint. It makes the process of income computation for filing of return of income easier.

Objectives of Tax Audit

Tax audit is conducted to achieve the following objectives:

- Ensure proper maintenance and correctness of books of accounts and certification of the same by a Chartered Accountant (tax auditor)
- Reporting observations/discrepancies noted by the tax auditor after a methodical examination of the books of account
- To report prescribed information such as tax depreciation, compliance of various provisions of income tax law, etc.

These enable tax authorities to verify the correctness of income tax returns filed by the taxpayer. Calculating and verifying total income, claims for deductions, etc., also becomes easier.

Applicability of Tax Audit

The Income Tax Act, Section 44AB, mandates tax audits for two categories of taxpayers:

1. **Businesses**: A tax audit becomes compulsory if a business's gross turnover exceeds Rs. 1 crore in the preceding financial year.

2. **Professionals**: Professionals whose gross receipts surpass Rs. 50 lakhs in the preceding financial year are liable for a tax audit.

we have summarised other circumstances where taxpayers need to get their tax audits done

Category of person	Threshold for Tax audit
Business	
- Businesses not opting for presumptive taxation scheme	If total sales, turnover, or gross receipts exceeds Rs. 1 crore during the fiscal year.However, if cash transactions does not exceed 5% of total gross receipts and payments, the turnover threshold for tax audit is raised to Rs. 10 crores.
- Businesses not eligible for presumptive taxation under Section 44AD - if assessee opt out of presumptive taxation within the lock in period i.e., 5 consecutive years	If an assessee opts for presumptive taxation under Section 44AD, they are required to consistently follow it for five consecutive years. However, if the assessee opts out by either declaring a lower profit percentage (i.e., less than 8%) or exceeding the prescribed turnover limit, and their income for the year surpasses the basic exemption limit, they will be liable for a tax audit.
- Business under the presumptive taxation scheme (Section 44AD)	As per section 44AD, any assessee in eligbile business can opt for presumptive taxation i.e., to declare profit more than 8% of gross receipts or tunorver without maintaining books of accounts. However, this exemption is available only to those assessee whose total sales, turnover, or gross receipts does not exceeds Rs. 2 crore in the fiscal year. This limit of 2 crores is further extended to Rs. 3 Crores, if cash receipts does not exceed 5% of the total receipts. Therefore, if the assessee chooses presumptive taxation and meets the turnover or gross receipts criteria, a tax audit is not required. Note: Eligible business excludes businesses of agency, commision, plying , hiring or leasing goods carriages.
Profession	
- Non-presumptive taxation scheme	If total gross receipts exceeds Rs. 50 lakh during the fiscal year.
- Presumptive taxation under Section 44ADA	If an assessee declares taxable income less than 50% of the total gross receipts under presumptive taxation and his income exceeds maximum exemption limit, then tax audit shall be applicable.
- Profession under the presumptive taxation scheme (Section 44ADA)	Similar to businesses, Section 44ADA offers a presumptive taxation scheme for specified professionals, allowing them to declare 50% of their gross receipts as income without the need to maintain detailed books of accounts. A tax audit is required only if the gross receipts exceed Rs. 50 lakh in a financial year or if the assessee declares profits lower than 50% of the gross receipts. The Rs. 50 lakh threshold is extended to Rs. 75 lakh if cash transactions constitute not more than 5% of the total gross receipts.

Forms Required to be furnished under Tax Audit Report

Any person who is required to get a tax audit would be required to furnish the following forms:

Form 3CA-3CD: This form is applicable for the person who is required to conduct an audit under any other law, like the Companies Act 2013

Form 3CB-3CD: This form is applicable to the person who is not mandated to conduct an audit under any other law.

❖ GST Annual Returns

GST annual returns are a critical component of the GST compliance process. They require a comprehensive review of records, returns, and other relevant documents to ensure accurate reporting of turnover, tax liabilities, and input tax credits. By filing accurate annual returns, taxpayers contribute to the integrity of the GST system and demonstrate their commitment to compliance. The GST authorities use these returns to verify the accuracy of tax assessments and identify any potential discrepancies or non-compliance issues. There are two types of GST annual returns namely GSTR 9 and GSTR 9C.

Applicability of GST Annual Returns

- **GSTR 9 Filing:** GSTR 9 is an annual return required to be filed by all registered taxpayers. The GST law does not specify any turnover limit for GSTR 9. However, to ease compliance burden for small businesses, the department made GSTR 9 optional for businesses with turnover up to Rs 2 crores.

- **GSTR-9C Filing:** Businesses with an aggregate annual turnover above Rs 5 crores are required to file certified reconciliation statement in Form GSTR-9C along with audited financial statements, but without the requirement of a Chartered Accountant (CA) or Cost Accountant certification. Previously, GSTR-9C was required to be certified by a Chartered Accountant (CA) or Cost Accountant. However, this requirement was removed by Sec. 110 of The Finance Act, 2021 (No. 13 of 2021) brought into force w.e.f. 01.08.2021 vide Notification no.29/2021-C.T. dated 30th July, 2021.

Key Objectives of GST Annual Returns:

- **Compliance Verification:** To ensure that businesses are accurately reporting their GST liabilities and paying the correct amount of tax.
- **Fraud Detection:** To identify instances of tax evasion, avoidance, or other fraudulent activities related to GST.
- **Risk Assessment:** To assess the level of risk associated with a business's GST compliance and identify potential areas of concern.
- **Deterrence:** To deter non-compliance by demonstrating the seriousness of GST violations.

Common Areas of Focus in GST Annual Returns:

- **Input Tax Credit (ITC) Utilization:** Verification of the accuracy of ITC claimed and its proper utilization.
- **Invoice Verification:** Checking the authenticity and completeness of invoices issued and received.
- **Valuation of Goods and Services:** Ensuring correct valuation of taxable supplies.
- **Classification of Goods and Services:** Confirming the accurate classification of goods and services under the GST regime.
- **Record-Keeping:** Assessing the adequacy and accuracy of the entity's record-keeping practices.

❖ Transfer Pricing Audit

Transfer Pricing (TP) audit is a specialized type of audit conducted to assess the fairness of transactions between related parties within a multinational group. The fee that one business charges its associated business for the goods and services it has provided is referred to as transfer pricing. In India, TP audits are conducted under the provisions of Income Tax Act to ensure that the transactions are at arm's length, meaning they are priced as if they were between unrelated parties.

Applicability of TP Audit in India

TP audits are applicable to Indian taxpayers who have transactions with associated enterprise located outside India and in some cases within India. The term "associated enterprise" is wider term and broadly covers the following:

- Subsidiaries
- Holding companies
- Associated enterprises
- Family members

The certification of the international transactions executed by the taxpayer will be submitted in Form 3CEB duly certified by the Chartered Accountant.

It is applicable to taxpayer that are engaged in international and specified domestic transactions with any associated enterprise. This Form must be filed irrespective of the value of international transactions, but for specified domestic transactions, only if the value exceeds Rs. 20 crores in a fiscal year.

A thorough report called as "Transfer Pricing Study Report" is required to be prepared analysing whether transaction executed between associated enterprises is at arm length price. This TP Study report is mandatory when amount of international transaction is more than Rs. 1 crore. This is an additional compliance in addition to filing Form 3CEB.

Purpose of TP Audit:

The primary purpose of TP audits is to:

- **Prevent Tax Evasion**: Ensure that taxpayers are not shifting profits to low-tax jurisdictions to reduce their tax liabilities.
- **Promote Fair Competition**: Prevent unfair advantages arising from non-arm's-length transactions.
- **Enhance Tax Revenue**: Increase tax collections by ensuring that taxpayers pay their fair share of taxes.

Key Aspects of TP Audit:

- **Arm's Length Principle:** The audit assesses whether the transactions are priced at arm's length, considering factors like comparable uncontrolled transactions, functional analysis, and economic analysis.

- **Documentation Requirements:** Taxpayers are required to prepare and maintain TP documentation, which includes information about the related parties, nature of transactions, and the arm's length pricing methodology used.

- **Methods of Pricing:** Various methods are used to determine arm's length prices, including the comparable uncontrolled price (CUP) method, the resale price method (RPM), the cost-plus method (CPM), and the profit split method (PSM).

Penalties for Non-Compliance:

If a TP audit reveals non-compliance with the arm's length principle, the taxpayer may be subject to penalties, including:

- **Tax Adjustments:** The taxpayer may be required to pay additional taxes on the difference between the arm's length price and the actual transaction price.

- **Penalties:** Penalties may be imposed on the taxpayer for non-compliance with TP regulations or for providing inaccurate information.

❖ Conclusion

In conclusion, audits play a crucial role in ensuring financial integrity, accountability, and compliance. From statutory audits that provide external validation to internal audits that assess organizational processes, each type of audit serves a unique purpose. Understanding the objectives, methodologies, and applicability of different audits empowers businesses to make informed decisions and navigate the complex regulatory landscape.

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❖ Special Mention:

Thank you, **Anuj Mantri**, for successful compilation of this Knowledge Series.

❖ Compliance Calendar for the month of October 2024

S. N.	Due Date	Compliance
1	07 October	Payment of TDS/TCS (Monthly)
2	07 October	Payment of Equalization Levy
3	07 October	ECB-2 Return
4	11 October	GSTR-1 (Monthly)
5	13 October	B2B Invoice Reporting through IFF (QRMP Scheme)
6	13 October	GSTR-6 (ISD Return)
7	15 October	Payment of ESIC and Return
8	15 October	Payment of PF and Return
9	15 October	Filing of TCS Returns for Q2
10	18 October	CMP – 08
11	20 October	GSTR-3B (Monthly)
12	25 October	GSTR-3B (Payment under QRMP)
13	30 October	LLP Form 8 -Filing of statement of accounts.
13	31 October	Monthly Return of PTRC
14	31 October	Filing of TDS Returns for Q2
15	31 October	Form 3 CEB
16	31 October	ITR for Companies to which TP is not applicable.
17	31 October	ITR for assessee other than companies where tax audit is applicable.
18	31 October	Form MSME 1

❖ GC CORNER:

We celebrated Ganesh Chaturthi at RRCO and welcomed Ganpati Bappa with great joy.