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Genesis of Audit in India, US and UK

Ruth Vaiphei*
Assistant Professor
Institute of Chartered Financial Analysts of India (ICFAI) University, Dehradun, Uttarakhand, India

Abstract

The importance of audit in today's world is undeniable. In view of the economic condition, focus of an auditing was mainly detection of frauds and errors but in recent times. it is also used as a tool for assessing the truth and fairness of the financial statements of the companies. Also, the function of audit was mainly to add credibility to the financial statement prepared by the managers of the company for the shareholders. The main motive of the company is to raise capital and all about profit making, and in this belief the investors invest their money. Therefore, it is important that the capital raised by a company is used for lawful purposes and objects for which it raises the capital from the investors. To ensure this, auditors are under a duty to audit the company. An audit provides a high level of assurance about accountability matters, which is expressed as a reasonable assurance. A higher audit quality will provide better information to them and by virtue of its vital importance in every management, the researcher attempted to trace the evolution and consideration of its importance. The paper also categorized different eras in order to know the definite time zone of the audit used and existence of the concept and the evolution of audit. Further, for better understanding, the paper analyzes the genesis of auditing in every aspect in the context of various countries and to enable to draw the advance approach of the same.

Keywords: *Assurance, Audit in, Economic, Capital, Companies, Countries*

****Author for Correspondence*** Email: ruth.vaiphei@iudehradun.edu.in

INTRODUCTION

Company is the most popular form of business entity today as compared to some traders and partnerships. Each decade passes with more and more companies being formed to do business. A company is able to raise capital for its operational needs from the market. However, it is important that the capital raised by a company is used for lawful purposes.

To ensure this, auditors are under a duty to audit the company. Nevertheless, if the duties and obligations of auditors are minimal, eventually, the capital raised by the company from the market will be misused. Simultaneously, businesses are also collapsing whereby it affects the rights and interests of the shareholders and stakeholders. Since such is the magnitude on the importance of auditors, equal importance should be placed on the duties and obligations of auditors. An audit provides a high level of assurance about an accountability matter which is expressed as a reasonable assurance. Otherwise, the information contained in the report would be lost and misleading. The duties and obligations of auditors must be expanded for the sake of capital market, stability of financial and economic sector, and the rights and interests of shareholders and stakeholders. A higher audit quality will provide better information to them. There must be a modern approach to the auditors' duties and obligations in the context of corporate governance. In general, the term corporate governance is well summarized as being concerned with the process by which corporate bodies are subjected to accountability mechanisms [1].

For better understanding of the concept of auditing the researcher intends to analyze the genesis of auditing of various countries and find out the advance approach of the same.

ORIGIN OF AUDITING

The concept of auditing an account of public institution is not something new; it has been the practice since the ancient Romans, Greeks, and Egypt. In those days, auditing was conducted by clerks who were mainly appointed to check the public accounts, whereas in today's context no clerk performs the role of auditor. Notwithstanding the role of auditing played in different eras, the object of auditing is all the same.

The 18th century known as the industrial revolution can be termed as the juncture when the auditor's roles came into limelight. The auditor was an independent person and whose obligation was mainly to check the accuracy of accounts [2]. It is well known that the need for this independent person was brought by the force of industrial revolution, which resulted in large scale production, and improved steam power as well as facilities for better means of communication. Another impact was that joint stock form of organizations came into being where the shareholder became a mere contributor of capital, who has limited knowledge about the working of the organization and its financial position. This invoked the need for an independent person who would allocate any manipulation or fraud and bring to the attention of shareholders, and the auditor played a key to ensure safety of shareholder investment.

The Indian Companies Act, 1913, envisages certain criteria and procedure for appointment of an auditor and in 1949, the Chartered Accountant Act was passed. The policy for auditing has changed after the industrial revolution; as a result, the person to be appointed as an auditor must fulfil the required criteria and standard of the Institution of Chartered Accountants of India.

Origin of Auditing Concept in India and Developed Countries

Prior to 1840, auditing was found in the ancient civilization of China, Egypt and Greece in the form of checking activities. The checking activities of Greece appear to be somewhat like present days auditing. Whenever any embezzlement committed has been proved against any public officers and convicted by the court, he shall be subjected to fine which shall be up to ten times the sum discovered to be embezzled/stolen. Also, if the court convicted anyone of corruption shall be subjected to a fine which is ten times of the amount of bribe [3].

Similar kind of checking activities were also found when the Exchequer of England was established during the reign of Henry-I. To monitor the state revenue and expenditure special officer were appointed to make sure that the transactions were properly accounted for and to prevent any fraudulent action. And the person responsible for the examination of accounts was known as "auditor".

Similarly, the system of checking activities was found in the Italian City State where the merchants of Venice, Florence etc. used auditor for detection of fraud. It was used to determine whether any defalcation has taken place in the accounts of the government offices [4].

Prior to the Industrial revolution, economic activities during those periods were mainly concerned with cottages and small business house which were individually owned and managed. Hence, there was no need for managers to report to the owner on the management of resources. Thus prior to industrial revolution audit has little to do commercially [5].

It may be stated that prior to 1840 auditing at that time was just for the purpose of performing detailed verification of every transaction and the audit objective was mainly designed to check the honesty of the persons/officials in charge of government revenue and expenditure.

1840s-1920s (industrial revolution era)

The Joint Stock Companies Act was passed in 1844 in the UK during the period of Industrial Revolution in response to socio economic developments during the period. The act has stipulated that the directors shall be responsible in maintaining the books of the company and full and fair presentation of Balance Sheet is to be made up [6].

The accountant during those periods was merely a manager of a company assigning with the responsibilities and duties of ensuring proper used of funds entrusted to him. And the auditors during those periods were merely chosen from among the member to perform a complete checking of transaction and preparation of financial statement with a little attention to the internal control system of the company.

The objectives of auditing were: (i) the detection of fraud; (ii) the detection of technical errors, and (iii) the detection of errors of principles. Thus, the role of auditor during those periods was mainly detection of fraud and error and proper presentation of the state of affair of the company in the balance sheet [7].

1920s-1960s

With the growth of US economy between 1920s-1960 there has been a shift of the auditing development from the UK to the US. After the Wall Street Crashed in 1929 and the following years on its recovery, there has been a rapid increased of investment in business entities. Meanwhile, with the improvement of the securities markets and financial institutions had facilitated the development of capital market. As the companies grew, the segregation of ownership and management became even more evident. Hence, to ensure the smooth functioning of the financial market and continuous flow of fund from the investors to the companies there is a need to convince and gain the confidents of the market participant by presenting a true and fair state of affair of the company's financial position in the financial statement [8].

The focus of an auditing function from detection of fraud and error has been shifted toward assessing the truth and fairness of the financial statements of the companies during this period. In view of the economic condition, the function of audit was mainly to add credibility to the financial statement prepared by the managers of the company for the shareholders rather than just detection of fraud and errors [9].

Due to sizable/large transactions involved in the conduct of business by large corporation operating across widespread locations during this period it has become impossible for the auditor to verify all the transactions. As a result, sampling and development of judgment of materiality were essential. Thus, the concept of materiality and sampling technique developed [10].

Also following the sampling technique, the auditor also needs to rely on the internal control system of the management to facilitate their auditing approach [11].

However, With the enactment of Securities Exchange Commission Act in 1934 in the USA and the Companies Act 1948 in the UK the audit of the profit and loss account of the company has been made mandatory.

1960s-1990s

As the world economy continues to grow during these periods, an auditor of companies plays an important role in enhancing the credibility of financial information and enhanced the operation of effective capital market. The auditing approach and procedure has undergone a change from "verifying transaction in the books" to "reliance on the internal control system". The continued growth in size and complexities of the companies due to the increase in the number of transactions has resulted in such change [12].

Then in the mid-80s the risk-based auditing approach was developed in which the auditor will focus on those areas in which errors are more likely to occur. And to adopt this approach, the auditors are required obtain a thorough knowledge and understanding of the operating environment, the industries, the policies and key personnel of their clients [13].

With the advancement of information technology during this period most of the companies had processed their financial information and other data using the computer system to perform, monitor and control over their operational and administrative process. In the same way to facilitate the audit procedures, the auditor placed their trust on the advance auditing computing tools and in addition to auditing financial statement the auditors provide advisory service to their audit clients at the same time.

1990s- till date

As a result of the rapid growth of the world economies there has been a substantial and rapid change in the auditing profession since the 90s. At present it may be observed that auditing has gone beyond basic attest function of financial statement. As every business has its own business risk perspective, and such business risk if left uncontrolled will ultimately affect the financial statement. And further by understanding the wide range of risks in the business, the auditor will be in better position to identify the important matters which has relevance to the audit profession at proper time [14-19].

Also, with the increasing concern regarding corporate governance in the early 90s the responsibility of the auditor in their auditing profession has been increased and the adoption of business risks approach has enhanced the ability of the auditor to render these responsibilities and thus open an opportunity to auditor and auditing firms to render consultancy services to the businesses. By 2000, when the consulting service revenue exceeds the auditing revenue in all the major auditing firms in the USA, this has raised a doubt from the regulators and investing public point of view as to the independent of the audit firm [20].

With the scandal of public companies like the Enron, WorldCom etc. the quality of audit has been placing under scrutiny and the independence of the auditor has been proven to have been compromised. And because of this there has been a major reform undertaken in various countries by the accounting bodies, the regulators, stock exchange commission, governments to strengthen the auditing practice. Some of key reforms activities included: (i) The Sarbanes-Oxley Act (The US), (ii) Ramsey report (Australia) etc. [21]

Origin of audit in the Indian context

The history of Indian accounting and auditing profession existed in ancient India since the fourth century BC. Auditing is as old as accounting. The Vedas and Arthashastra by Kautilya broadly cover and contained a reference to accounts and auditing, accounting rules and standards. Detection and prevention of frauds and errors was the original objective of auditing. Similarly, in India like in the UK, and with the growth of Joint Stock Companies where the owner and management become segregated auditing has grown rapidly. Audits were carried out to report to the shareholders who were the owners of the company on the account of the company. Then the objective of audit was shifted to ascertain whether the accounts of the company represent a true and fair state of the affair rather than just detection of fraud and errors.

Audit in India was primarily associated with the objective of (i) reporting to the shareholder and the government as to whether or not the company's financial statement reflects a true and fair state of its affair and of any profit or loss derived during the financial year and (ii) incidental objective, concerning the detection and prevention of fraud and errors.

In India the audit of company's account has been made compulsory since the passing of the first Companies Act in 1913. Since then the Institute of Chartered Accountant of India (ICAI), was established as a statutory body under the Chartered Accountant Act of 1949 regulating the profession of Chartered accountant in India and members of the institute and also setting the accounting standards.

MEANING OF AUDIT

Auditing refers to a systematic independent examination and verification of financial information of an entity/organization viz. books of accounts, transaction records, other relevant documents and vouchers etc. and physical inspection of inventory of an organization whether profit oriented or not by qualified accountant (auditors) to ascertain how far or whether the financial statements present a true and fair view of the affair of the concern. A never-ending attempt is to ensure that the books of accounts are properly maintained by the concern as required by law. Also, audit is done with a view to express an opinion on the financial statement or affair of the company. **Prof. L.R. Dicksee** define audit as "auditing is an examination of accounting records undertaken with a view to establish whether they correctly and completely reflect the transactions to which they relate".

In other words, audit means third-party examination of the company's financial records and reporting activities. The auditor will check for accuracy and full representation of the financial activities and claims. The auditor perceives and recognizes the propositions before him/her and formulates an opinion based on his judgment which is communicated through his audit report.

Audit may be conducted for various purposes under various laws, acts or regulation. Other areas which are commonly audited include: internal controls, quality management, project management, water management, and energy conservation etc., but in this topic the study is all about audit under the Company's Act and its role in Corporate Governance that is Statutory Audit. The term is most frequently applied to audits of the financial information relating to a legal person. Audits provide third party assurance to various stake holders that the subject matter is free from material misstatement. As a result of an audit, stakeholders may effectively evaluate and improve the control management risk of all-time governance process over the subject matter [22].

An audit can also be define as an objective examination and evaluation of the financial statements of an organization to make sure that the records are a fair and accurate and represents true state of affair an entity/organization as claimed.

The word audit is derived from a Latin word "audire" which means "to hear". Though audit exist since medieval times when manual book-keeping was prevalent. Also, audit is traditionally associated with gaining of information with regards to financial systems as well as corporate business financial records. But in the present scenario due to compelling incentives arising from the misstatement of financial information, therefore auditing has become a legal requirement for many entities that have the power to exploit financial information for personal gain. However, misstatement of financial information may not always be the case of fraud it may also be due so some clerical errors. Hence the purpose of audit is also detection of any fraud or errors and to report thereon.

Also audit exist not just because they are required by law, but they add value through easing the cost of information asymmetry for example, a privately-held company that does not issue securities on a public exchange might engage a firm to audit its financial statements in order to obtain more desirable loan terms from a financial institution. Without the audit, the lending party would not have assurance as to whether the company's financial position is accurate.

Internal Auditor

Internal auditors are usually employee of the company/organization and appointed internally by the management i.e. Board of Directors. They work internally within an organization and report or give recommendation/ suggestion to its audit committee and/or Board of Directors. The internal auditor assists the management in organizing the company's organizational internal control system and by taking into account the operating environment and business in which its organization operates assist the management in developing standards/ policies for specific risk management. They also ensure that all policies implemented for risk management are operating effectively and are also being followed. The work of the internal auditor tends to be continuous in nature and based on the internal control systems of a business of any size [23].

As per **Section 138** of the Companies Act, 2013:

(*1*) *Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.*

(*2*) *The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board*.

Also, the Companies (Account) Rules, 2014 required certain class of companies to appoint internal auditor.

In the past the internal auditing activities has been generally regarded as informal when it relates to corporate governance and its auditing process is accomplished mainly through its participation in meeting and through discussion with the management. The internal auditor is often considered as one of the "four pillars" of corporate governance. The others are the management, Board of Directors and the external auditor [24].

In relation to corporate governance the main area of focus of internal auditor is to assists the Audit Committee of the board or the management in performing its oversight responsibility for the financial reporting process, the system of internal control, the audit process and the company's process of monitoring compliance with various laws and regulations and the code of conduct. This may include proper coordination with the external auditor and the management and to ensure that the audit committee's also received effective information. Also, the internal auditor shall report to the management any critical issues regarding controls and shall also suggest questions or set up topics for the Audit Committee' s agendas. In recent years, the Institute of Internal Auditors (IIA) has advocated a more formal evaluation of corporate governance, particularly in the areas of board oversight of enterprise risk, corporate ethics and fraud.

But since the internal auditors as stated earlier is usually an employee of the company or organization that employed them; therefore, the question of independence and objectivity are cornerstone of Institute of Internal Auditor professional standards [25-27].

External Auditor:
As against the internal auditor external auditor who plays the main role in corporate governance process is an audit professional (chartered accountant holding a certificate of practice) who perform an audit on the financial statement of the company or any other legal entity or organization. External auditors are appointed by the shareholders of the company at the General Meeting of the Company and are independent of the organization/entity they are auditing. They are appointed to express an opinion on the accountability matter. They report to the company's shareholders. They provide their experienced opinion on the truthfulness of the company's financial statements and perform work on a test basis to monitor that the systems in place. In India it is prima facie requirement that every company shall at the First Annual General Meeting (AGM) appoint an auditor who can either be an individual or a firm.

Section 139 (1) of The Company's Act, 2013 read with **rule 3** of Companies (Audit and Auditors) Rules, 2014 every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed [28].

In the case of a company that is required to constitute an audit committee under section 177 of the Company's Act, such committee, and in cases where such committee is not required to be constituted, the Board shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size/nature and requirement of the company.

Provided, that the company shall place the matter relating to such appointment for ratification by members at every annual general meeting.

Provided further that before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

Also, that the certificate shall also indicate whether the auditor satisfies the Criteria provided in **section 141**.

Provided also that the company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within fifteen (15) days of the meeting in which the auditor is appointed.

As per **Section 141** (*1*) *A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant:*
Provided that a firm whereof majority of partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.
(*2*) *Where a firm including a limited liability, partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.*
(3) The following persons shall not be eligible for appointment as an auditor of a company, namely:
a) A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
b) An officer or employee of the company;
c) A person who is a partner, or who is in the employment, of an officer or employee of the company;
d) A person who, or his relative or partner—
(i) Is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:
Provided that the relative may hold security or interest in the company of face value not exceeding one thousand rupees or such sum as may be prescribed;
(ii) Is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or
(iii) Has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed;
e) A person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;
f) A person whose relative is a director or is in the employment of the company as director or key managerial personnel;
g) A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;
h) Person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
i) Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.
(4) Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

CONCLUSION

The corporate disaster that has taken place from time to time, especially of high-profile corporate have cause the emergence of Corporate Governance as a solution or remedy and an inevitable positive philosophy of responsible management.

As compared to sole proprietorship business, company is one of the most common and accepted form of business entities now a days. Every now and then, more and more companies are being formed to do businesses, as companies can raise capital from the market to fulfill its operational requirements. Nonetheless, it is of vital importance that the capital raised by the company is being used for lawful activities and for the purpose for which it's being raised. Hence, to guarantee the proper uses of capital raised by the company, the auditors are under the obligation to audit the accounts of the company. However, if the duties and obligations of the auditors are limited, the accounts and financial statements of the company and its uses will be distorted. Thus, the rights, duties and responsibilities of the auditors are being spelled out under different statutes and regulations in different countries across the globe. Audit provides and elevated level of assurance about the credibility and accountability issues which is expressed as reasonable assurance, or else the purpose of preparing the financial statements by the company would be defeated as the information contained in the financial statements would be cumbersome without being properly audited. Also, for the purpose of ensuring the stability of the capital market and of the financial and economic sectors and to enhance the rights and interest of the shareholders and various stakeholders, the duties and responsibilities of the auditors has been extended.

Similarly, a better audit quality enhances credibility and provides reliable information to the various users of the financial statements of the company.

Also, the purpose of disclosure requirement would be defeated, if the information is not precise and well-timed. Hence, consistent financial information is necessary for the investors and other stakeholders. Thus, the disclosure requirement must be supplemented by an independent assessment and legal rules permitting private litigations. The analysis of the financial statements or financial information of the company is generally done by certified accountant or auditing firms and the auditors owes their duty to verify the financial statement issued by the company's management in accordance with the auditing standards and certify the same.

Apparently, the independence of the auditor is of vital importance for the authenticity of the financial statements, otherwise the purpose of auditing the financial statements of the company would be defeated.

From the above analyses it can be drawn that auditing plays a vital role in every management, and the researcher decline to conclude that any particular country has found the concept of auditing earlier than any other countries, since the concept exist time immemorial and it is a complex task to draw a definite period and to define a certain juncture would be wrong, also the existing of the concept is evidence after much research but the difficulties of certainty arise as it was performed by person of different profession unlike the current scenario where it is a work done by a person designated profession of auditing. Whatsoever, the audit function should be regarded as a mechanism to protect the interest of the shareholders, the investors and other stakeholders.

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