Auditing: Introduction:

Evolution:

The word "audit" has been derived from the Latin word "audire" meaning "to hear", "listen" or "give credence to". In ancient days an Auditor used to listen to the accounts read out by the accountant in order to check them.

Auditing was used in all countries such as Mesopotamia, Egypt, Greece, Rome, U.K. and India. The Egyptians, the Greek and the Romans used to get their public accounts audited. Audit of accounts of private house was rare. Even in India Auditing from the times of Vedas, Ramayana, and Mahabharata. Basically accounting and auditing had their origin in the need for the government to control the income and expenditure of the state and the army.

The industrial revolution in the 18th century and also advent of joint stock companies increased the number and complexity of business transactions. In these companies management and ownership was different. The director manages these companies but the real owners were the shareholders. This gave stimulus to the development of auditing process.

Due to increase in the number of companies, companies act made it compulsory to audit the book of accounts and give report to the real owner i.e shareholders. In India, companies act 1913 made it compulsory of audit of accounts. After independence the companies act 1956 enlarge the scope of auditors work and a power transferred to the Institute of Chartered Accountants of India through Chartered Accountants 1949. Presently only a practicing Chartered Accountant can act company auditor.

Definitions:

Different experts and association have defined Auditing varyingly. Let us discuss and understand some of the important definitions:

The International Auditing Practices Committee defines Auditing as "The independent examination of financial information of any entity, whether profit oriented or not and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon."

Auditing and Assurance Standard (AAS1) by ICAI:

"Auditing is the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expression an opinion thereon"

According to Ronald Irish

"Auditing in its modern concept, is a scientific and systematic examination of books, vouchers and other financial and legal records in order to verify and report upon the facts regarding the financial condition disclosed by the balance sheet and the net income revealed by the profit and loss account."

Objective of Auditing:

"The main object of an audit is to ascertain that the Balance Sheet and Profit & Loss Account of an undertaking is showing true and fair view of its financial positions and earnings." However objectives of audit can be divided into two different parts:

1. Primary objectives
2. Secondary objectives

1 **Primary objectives / Basic objectives**

The main or primary objective of Auditing is to find out the reliability and validity of the financial statements so as to render opinion on the truthfulness and fairness of the presentations in those statements. The auditor has to give an opinion on financial statements whether they are True and Fair view i.e whether a) Balance sheet shows true and fair view of the concern, b)the profit and loss accounts give a true and fair view of the profit or loss of the concern, c)all the material facts has been disclosed, d) the organization has followed all the compliance with regarding to legal requirement and e) Final accounts are made according to the recognized accounting principles and auditing standards laid down by professional bodies, like ICAI.

2. Secondary objectives / Incidental objectives

The secondary objective of audit is to detect and prevent the errors and frauds. An error is generally taken to be innocent and not deliberate. Where it appears to be willfully made, it assumes the character of a fraud.

The term "fraud" refers to an intentional act by one or more individuals of management, employees or outsiders, severally or jointly, involving the use of deception to obtain an unjust or illegal advantage.

It's not an objective of an audit to give a guarantee that all is well with the concern. A clean audit report does not imply that the management has efficient.

Procedure to detect Errors:

Following procedure the auditor should follow to detect errors:

1. First start with the checking of the opening balance with the last year audited balance sheet.
2. After checking of opening balance start verifying the journal entry and then checking of posting into respective ledger accounts.
3. Than verify the subsidiary books.
4. Verify all the casting and carry forwards.
5. After that verify trial balance.
6. Compare the current year trial balance with the last year trial balance.

7. Calculate the total of both the side of trial balance if difference found than divided the difference amount with 2 figure which you arrive start find the amount in the ledger. Take for example difference in the trial balance is Rs.20000 than divide the amount with 2 so amount you arrived is Rs.10000 start finding Rs.10000 in the ledger.

Frauds:

Fraud means intentional misrepresentation of financial information by management, employee or third parties.

Fraud may be of following types:

1. Fraud through defalcation.
   a. Misappropriation of cash
   b. Misappropriation of goods
2. Fraud through accounts
   a. Not recording a transaction
   b. Recording the dummy transaction

1. **Fraud through Defalcation**: following are the method of defalcation involving misappropriation of cash or goods:

   A Misappropriation of cash
   a. Misappropriation of cash receipt by not recording the same,
   b. By suppressing the cash either not recording the cash or showing them as credit sales,
   c. Showing payment twice in the cash book
   d. By teeming and lading procedure that is cash received from one debtor is appropriated and deficiency in that accounts of debtors is made good when cash received from second debtors and the deficiency in the second debtors is made good when cash received from third debtors and so on…

   B Misappropriation of goods:
   a. Goods may be misappropriated by showing dummy sales,
   b. Goods are actually received in the organization but are shown as not received and good are misappropriated.

2. **Fraud through accounts**

- Not recording a transaction: These types of errors are intentional like sales take place but not shown in the books of accounts.
- Recording Dummy transaction: examples of these types of errors are showing wages or salary in the dummy workers accounts.

Circumstances indicating Errors and Fraud:

The circumstance indicates that there may exist errors or fraud:

1. Management is in the hand of single person
2. Internal control in the organization in either week or does not exist at all
3. Turnover of the accounting staff is very high,
4. Professionals in the organization like lawyers or auditors are changes very frequently,
5. Depending on the few product or few customers
6. Working capital in the organization is inadequate

7. In the need of issue of share financial picture is to be shown in the better position,
8. Investment in the product line which is subject to rapid obsolences,
9. There are many transaction with associates, related parties etc..
10. Organization is making excessive payment for services,
11. Vouchers which are available for audit is not duly authorized or supporting document for the same is not available.

Auditor's responsibility for errors and fraud: ICAI has spelt out the responsibility of an audit for errors and fraud in ASS 4.

1. **Basic responsibility of Management:** It's basically responsibility of the management to detect and prevent fraud in the book of accounts. It is for the management to prevent and detect fraud and errors in the system.

2**. Incidental objective:** Basic objective of the audit is to state whether accounts are true and fair but with the basic objective the auditor incidental objective is to state that accounts are free from fraud and errors. While doing the audit the auditor should not only audit keep in mind books are true and fair but also free from major errors and fraud.

Basic idea behind is that auditor has taken a reasonable care for detecting errors and fraud. Though he is not responsible for errors and fraud but he should not fail in his duty to find out errors and fraud.

If during the audit auditor come to see that there exist errors and fraud in the book than he should take a reasonable step to rectify it. If there is error auditor should rectify it and confirm it. If there is fraud than if material he should state in the audit report.

Advantage of Audit:

The advantages of Audit are as follow:

1. **True and Fair Balance sheet**: Once the Balance sheet are audited user of balance sheet are sure that assets and liabilities shown in the audited balance sheet show the true financial position of the concern.
2. **True and Fair Profit and loss account**: the users of the profit and loss account are assuring that profit or loss in the profit and loss account is true and fair.
3. **As per the legal requirements**: audited Balance sheet means all the law applicable to the concern have been complied.
4. **Disclose all the material fact**: The audited financial accounts disclose all the material fact which is required by the investor for investment purpose.
5. **As per standards of accounting and auditing practice**: The ICAI has issued some standards of auditing and accounting, audited financial statement means all the standards are properly followed. This make audited balance sheet more reliable.
6. **Moral check on the employees**: Audit method or technique which auditors follow keeps the moral check on the employee. Any Errors found during the audit are removed this way keep the check on the employee.
7. **Tally with the books of accounts:** Audited financial statement means that it tallies with the books of accounts. Any users of financial statement need not look whole books of accounts but only see audited balance sheet.
8. **Detection of errors and fraud:** Audited financial statement means that financial statements are free from fraud and errors. Whenever any fraud or errors arise during

the time of audited are rectified. Auditors can also take the advice of expert or management to rectify the errors.

9. **Facilitates Taxation:** Tax authorities rely on the audit financial for tax purpose.
10. **Loans from Bank or any investors:** Any companies who want raise the loan through bank or any financial institution first step is to get the accounts audited.

Quality of auditors:

To be successful, an auditor should possess certain desirable qualities, besides having his formal qualification. His qualification requires that he should be a qualified chartered accountant. Besides, he should possess the following qualities:

1. Tactfulness
2. Cautious approach
3. Firmness.
4. Good temperament
5. Integrity etc.

He should be tactful in doing the job of auditing. Exile doing auditing, he should be cautious. He should have integrity, and independence.
He should posses the knowledge of common business laws. Like mercantile law partnership act, sale of goods act etc.
He should possess a thorough knowledge of taxation provisions prevalent in the country.
An auditor is required to critically comment upon the financial statements. He should posses' requisite expert in that field. He should occupy the position of an expert in that field. He should have through knowledge of all accounting principles and procedures. He should also know the ways and means in which the business is being conducted.
By possessing these qualities, he can become a successful and effective auditor.

Types of audit:

Audit is not a legal obligation for all types of business organization. On these basis audit can be of two main types:

Statutory Audit:

An audit which is made mandatory under any law is called Statutory Audit or External Audit. The scope of statutory audit cannot be restricted. Various details such as scope of audit, qualifications of an auditor, his rights, duties and liabilities are fixed by the concerned law. Some such examples are:
1. The Companies Act, 1956 covering audit of limited companies.
2. The Banking Regulation Act, 1949 applicable to audit of banking companies.
3. The Insurance Act, 1938 governing audit of insurance companies.
4. The Electricity (Supply) Act, 1948 Governing Audit of Electricity Boards/Companies.
5. Cooperative Societies Act and Public and Charitable Trust Act of various states dealing with audit of these entities

Non Statutory audit: Where audit in the case of an enterprise is not compulsory by law, though it is opted for the enterprise in view of the several benefits resulting from it, it is called non statutory audit. In the case of a non statutory audit, the nature and scope of the audit is determined by the client. The auditor is required to conduct his examination within the limits determined by the client.

In India, for example, Sole Proprietary Firm, Partnership Firms, Joint Hindu Family business etc. are not required to get their accounts audited by an independent audit. Other audits are … like financial audit, tax audit, cost audit, environmental audit, gender audit etc…

Miscellaneous discussions:

Advantages of Independent Audit, Qualities of Auditors, Auditing Vs Accounting, Auditing Vs Investigation, View the Concept True and Fair

Audit Planning: Meaning, Objectives, Factors to be Considered, Sources of Obtaining Information, Discussions with Client, Overall Audit Plan.

Audit Programme: Meaning, Factors to be Considered, Advantages, Disadvantages, Overcoming Disadvantages, Methods of Work, Instruction before Commencing Works of Audit, Overall Audit Approach.

Audit working Papers: Meaning, Importance, Factors Determining Form and Contents, Main Functions / Importance, Features, Contents of Permanent Audit File, Temporary Audit File, Ownership, Custody, Access of Other Parties to Audit Working Papers, Auditors Lien on Working Papers, Auditors Lien on Client's Books.

Audit Notebook: Meaning, Structure, Contents, General Information, Current Information and Importance.

Auditing Techniques: Test Checking Vs Routing Checking, Test Check Meaning, Features, Factors to be Considered, When Test Checks can be Used, Advantages, Disadvantages and Precautions.

Reading of Ledger:

We have so far discussed the various accounts opened in the ledger and their classification.
Now we shall study the reading of ledger accounts, i.e., understanding the nature of the entries recorded in accounts and their meaning without the reference to the subsidiary books.

Reading of ledger accounts means 'interpretation of entries in ledger accounts'. Interpretation of ledger accounts involves the scrutiny of the accounts and drawing conclusions from them.

One should not only learn writing the books but should also be able to read and interpret the entries in the accounts written You already know, the ledger is the book of final entry and contains all entries recorded in various primary or subsidiary books, In the ledger, the entries are classified according to the nature of the transactions. Accounts contain only entries relating to that particular account. The reading of ledger account would therefore, reveal many things about that account *viz.* the natures of the transactions, volume of transactions, sequence of transactions and the balance on a particular day and the nature of that balance.

Need For Reading of Ledger Accounts of Auditor:

There are several parties which may require reading, interpretation and conclusions of ledger accounts such as debtors, lenders, banks units, courts, govt. departments and auditors. The following points bring out the significance of reading accounts of the auditor in particular.

I. Ledger accounts are maintained by profit making and non-profit making organisation such as proprietors, partnership firms, co-operatives, companies, etc.
II. It also enables him to ensure proper record of financial events in journal and subsidiary books.
III. The auditor can check whether opening record of financial events in journal and subsidiary books.
IV. He can make out as to whether the totals of ledger accounts are correctly made and closing balances are accurate.
V. He can verify whether ledger posting are correctly made.
VI. He can detect the errors of all kinds such as omission, commission and principles and the rectifications made.
VII. He can prepare the trial balance and ensure tallying of debit and credit sides.
VIII. He can see that final accounts such as profit and loss a/c, and balance sheet are scientifically formulated.
IX. He can detect any frauds committed by the staff members and fix the responsibility on them.
X. He can make sure that the responsibility of payment of various taxes and duties of the govt. authorities has been fulfilled.
XI. He can certify that the final accounts such as profit and loss account and balance sheet show correct profit or loss, and true and fair view of the financial position of the organisation.
XII. In case of legal dispute, the court may need copies of audited final account and other books such as documents, statements and ledger book.

Review ledger accounts: while the reading account of creditors, the transaction about creditor should be understood. The following entries should be understood:

a. Purchase of good on credit.
b. Purchase returns.
c. Payment of account.
d. Discount received.
e. Bills payable accepted.
f. Bills payable dishonor.
g. Amount paid directly by the party.

h. Bills receivable endorse to creditors.
i. Dishonor of bills endorse.
j. Dishonor of cheque.
k. Interest charged on overdue accounts.
l. Opening and closing balance.

Above transaction can be understood with the help of the following account

Sr. No	Particulars	Amount		Sr.No	Particulars	Amount
1	To B.p	Xx		1	By Bal b/d	Xx
2	To Bank	Xx		2	By Purchase	Xx
3	To Discount	Xx		3	By B.P Dishonored	Xx
4	To Return Outward	Xx		4	By bills receivable dishonored	Xx
5	To ABC A/c	Xx		5	By bank (cheque dishonored)	Xx
6	`	Xx		6	By discount	Xx
7	To Debtors A/c	Xx		7	By Interest	Xx
8	To Bal c/f	Xx		8	By expenses a/c	Xx

Rahul ledger
Anands account

Date	Particulars	Amt	Date	Particulars	Amt
2010			2010		
			April 10	By Balance b/d	200
2011			2011		
Mar 02	To Purchase return	500	Mar 01	By Purchase	2500
Mar 11	To payment	2000	Mar 09	By Purchase	2250
Mar 11	To Purchase return	450	Mar 26	By Purchase	4500
Mar 13	To Payment	1500	Mar 27	By Purchase	2500
Mar 31	To Balance c/d	7500			
		11950			11950

Solution:

I. **Type of account**: Mr. Anand is the creditor of Mr. Rahul so it will appear in the creditors account.
II. **Opening Balance:** Opening balance will be verified with the help of the audited balance sheet of the last year i.e. year 2010.
III. **Casting:** the total of the above ledger account Rs. 11950 is correct.
IV. **Review of the ledger account:** Auditor should verified following things
   a. No entries should be repeated.

- **b.** Entry should be done on chronological order of date.
- **c.** No entries should be changed.
- **d.** No entries are altered.
- **e.** No entry is inserted in between two entries afterward.

V. **Summary and grouping:**

a. First auditor should see that closing balance is properly disclosed i.e. it will shown on creditor schedules of the current liability less from current assets.
b. Auditor has to verify the purchase is not from group concern if so he has to mention under CARO 2003 regarding transaction is genuine or not.
c. Auditor has to verify that last purchase of the year is genuine or not that is whether they were return immediately in the next year, there may be possibility that the bogus purchase has been recorded to avoid tax.
d. The final balance should be checked into schedule of creditors.

Anand Ltd.

Cash A/c

Date	Particulars	Amount	Date	Particulars	Amount
2020			**2020**		
April 03	To B's Capita	6,000	April 02	By Salaries	1,000
April 04	To Sales	15,000	April 03	By Carriage	5,000
April 06	To sales	5,000	April 05	By Bank	3,000
April 08	To commission	1,500	April 08	By wages	12,500
April 09	To sales	6,000	April 09	By X's a/c	1,000
			April 10	By Bal C/f	11,000
		33,500			33,500

Anand Ltd
Purchase a/c.

Date	Particulars	Amount	Date	Particulars	Amount
2020			2020		
Mar 31	To Brought f/w from the month of feb	10,00,000	Mar 31	By purchase return	2,10,000
	To local purchase	3,00,000		By custom duty draw back	10,000
	To Purchase from group companies	30,000		By P/L a/c transfer	13,52,000
	To import	20,000			
	To freight inward	2,000			
		13,52,000			**13,52,000**

What is Audit?

https://www.youtube.com/watch?v=pkKO9ZNyOIc

The Audit Process

https://www.youtube.com/watch?v=rDjdLcwZEkg

Designing audit procedures - some examples

https://www.youtube.com/watch?v=9fNz4WJ4uZc

The Internal Audit

https://youtu.be/-p8Ms1iTEd0

The Framework for Internal Audit Effectiveness

https://youtu.be/G5a5vchrIh8

ISO Internal Quality Audit (IQA) Explained

https://youtu.be/fckZK6l678E

Auditing in Hindi - introduction of auditing

https://www.youtube.com/watch?v=H5A0pYJ1_78

Audit of Cinema ll Special Audits

https://www.youtube.com/watch?v=HBN-Ooh7sv0

Safety audit in Hindi

https://www.youtube.com/watch?v=k0m6Iz8L4M4

Audit of Hospitals ll Special Audit

https://www.youtube.com/watch?v=pbuCJpJ1ooQ

A Film on MGNREGS Social Audit Hindi

https://www.youtube.com/watch?v=fSoczGGHIj8