

PAPER-II AUDITING

BY – MR. ABHISHEK KUMAR

D.K. COLLEGE DUMRAON (DEPT OF BBA & B.COM)

EMAIL: abhikr0608@gmail.com

HELLO: 9931382760

UNIT-I AUDITING- MEANING , DIFINITION AND SCOPE

The word Audit is derived from Latin word “ audire ” which means ‘ to hear’.

After the modern accounting system organized by Mr. Lucas pecialo in 1494 this word became very important.

Definition: Auditing is a process ogf examine accounting records with the help of vouching and other accounting information.

However with the passes of time different author have define auditing with various approach which classified into narrow and wide approach.

Definition of narrow approach

According to Spicer and Pegler ,” Auditing is a process of examination of books of accounts and voucher of the business.

According to J.R. Batliboi,” Auditing is an activity of intelligence or critical scrutiny of the books of account for a business with documents and voucher for a particular period.”

It is cleared that auditing is an activity to examine the accounting record with voucher and it is satisfied that the profit and loss statement and position statement is true and fare.

Definition of wide approach

According to W.H.Hanson," an audit is the examination of such records to establish their reliability and the reality of statement which prepared by accountant."

According to L.R. Dicksee ," Auditing is an examination of the accounting records which under taken a view to establishing whether they correctly and completely reflect ."

According to Ronald A. Irish ," Auditing is a modern concept of systematic examination of book, voucher and other legal records in order to verify the financial position and profit & loss statement of the firm."

Conclusion:- on the basis of all above definition we can say that Auditing is the systematic examination of all accounting data , statement and books.

Characteristics of Auditing:

following are the characteristics of auditing:

- a) there must be an institution
- b) An auditor must be an independent person
- c) To examine the truthiness and fairness of the books of accounts
- d) Use of voucher
- e) Certain period
- f) Tactfully
- g) Report

#.Accounting begins where Book-keeping end and Auditing begins where accounting end. "Or"

Relation between Book-keeping, Accounting and Auditing

In olden days book-keeping , accounting and auditing have no distinction, they were thought to be synonyms for the sake of convince but for study this three words divided in three parts.

a) **Practical part:** – it is that parts where all the transactions of business were recorded in the books of accounts. Therefore in this part the process of maintaining account for all types was included.

b) **Theoretical part:** under this part trial balance is prepared at the end of the year of the business unit. To examine the accuracy of the business and prepared trading account, profit and loss account and the balance sheet with the help of all additional information and make decision regarding future.

c) **Analytical part:** It is that were practical and theoretical aspect of the business transaction were examine and prepare report on the basis of these examination.

All the above three part are now termed as boo-keeping , accounting , and auditing.

i) **Book-keeping:** - Book-keeping is the art of recording business transaction it is concerned with journalizing, totaling, posting and balancing the various account in the ledger.

The person who perform this work is known as book-keeper and for this work any person have general knowledge about accounting can do this work because its have no requirement of concept regarding accounting principle.

According to spicer and pegler,” book-keeping is an art to record business transaction.”

ii) Accounting :- It is the art of preparing financial statement such as fund flow statement, cash flow statement, balance sheet ,income statement.

it is a a systematic process of identifying, recording, measuring, classifying, verifying, summarizing, interpreting, communicating financial information

The definition of accountancy is the act of bring in a professional field called accounting which involves keeping track of financial record and doing taxes.

iii) Auditing- after preparing final account to examine their accuracy and truthiness. This function is done by auditor.

Auditing involve verification of the entry which are passed by accountant. It is the scrutiny of the accountant of a business with the help of auditing we satisfy himself after verifying and scruting of accounts as to the whether transaction entered. And auditor is required to submit his report to the effect weather balance sheet and statement of profit and loss

Here we say that when book-keeping end accounting begin and when accounting end bookkeeping begin.

#. Auditing is necessity while accounting is luxury: Do you agree with this statement

Accountancy is the necessity for any type of business because business either small or large there were so many transaction occurred and if we record them, we find out the position of profitability and other information related to the form

Hence we can say that accountancy is necessity. Following are the argument given ahead can we placed in favour of this statement...

1) Limitation of memory power:- there is a limitation of memory power of human who have not computer mind and it is not expected from it to memorize all the transaction held in a business for a long time period. Therefore it is necessary to record them into book for long time or permanent record.

2). Knowledge about profit and loss:- For the purpose of evaluate business profitability we obtain the rules of accounting and passed out the statement of profit and loss account

3) Knowledge of economic position of the business :- for the purpose of knowing the status of the business we obtain the rule of the accountancy

4) Proof in the court of law:- accountancy is a legal document which are important as a an evidence in court for the statement of the account with debtor and creditor.

5) need on admission of a new partner

6) Necessity after the death or retirement of partner accountancy is the necessity to settle his account

7) Helpful for adjustment as insolvent:- if a business is unable to discharge his liability he can apply in the court and file a petition for his insolvency.

8) helpful in the determination of various taxes.

9) Safety from fraud and forgery.

10) Helpful in getting loan.

“Auditing is luxury”

Auditing is luxury or not we, have to opinion regarded for this topic

1) opinion for small businessman:- Auditing is luxury for a small businessman. for the argument of this topic given following opinion.

a) This is more expensive for small business because trained accountant are appointed for the work of audit and they are required to payee good remuneration and small business cannot afford this expenses

b) Small business man can make alternative arrangement for the work of audit which proof to the economical

First they can prepare book of accounts themselves and second they can get the book of accounts prepared through others and examine themselves, this function is more economically

c) A small businessman has to observe a number of formalities for the work of audit this is more tough and expensive

d) This is wastage of time

e) This is used only for fulfilling a prestige

F) its decrease the efficiency of the employee

Hence we can say that auditing is luxury for small business

2.) Opinion for big businessman:- for the point of view of big businessman auditing is not luxury. It is necessity because

a) The efficiency of employee increase by auditing because if the books are not done perfectly they can be detected by the auditor.

B) In a large business organization where large number of employee are

engaged, increase the chance of fraud is more this chance of fraud is controlled by the help of auditor.

c) Its Increase the efficiency of Management

d) Due to the effect of the editing all the activities of the business become good then it to be helpful in the development of business.

e) By making comparative study of the audited financial accounts of different year we plan for future.

f) To protect the interest of the shareholder and debenture holder.

Hence we say that for a large business organization auditing is necessity not luxury.

Qualities of an Auditor

an auditor being high level to perform complex function he have all the good qualities of head and heart as is the editor by the nature of his job. He must be a man of character and good behavior as well as hard task maker as to do the work himself and get the work done through his assistance.

An auditor have two qualities involved these qualities are

1. Acquired qualities: under these quality an auditor have knowledge of following object

a) Knowledge of book keeping, accountancy and auditing.

b) They have knowledge of business technique

c) They should good knowledge of various language like Hindi, English, Marathi etc.

- d) He should also have good knowledge of economic principle
- e) Knowledge of various business activity and laws. such as contract act, insolvency act, income tax act, factory act, companies act, partnership act.
- f) Knowledge of audit case laws.
- g) He must have through knowledge of technical and other detail of the business.

2. Born quality : those quality which are inherited by the virtue of his birth are known as Born qualities. these qualities are God gifted and this qualities performance are some special. An auditor should following born qualities..

- a) **Honesty:-** An auditor must be an honest person and he should maintain their honesty always.
- b) An auditor should be efficiently to perform the complex work of auditing in all situations.
- c) **Speak truth:** they have high moral of character
- d) The interested in mathematics.
- e) The maintain secrecy
- f) They are a person who has patience.
- g) Ability to bring confidence.

#Objects and Advantage of Auditing

In present industrial age the scope of Industry and trade be expansion and also the importance of auditing has increase.

To error of human auditing going to through rectifying and posses with some technique that clarify these error become in used.

The main objective of auditing is to examine the document concerned in accounting so that there truthfulness and completeness can be judged.

This examination become more important when the owner of the business get the books of account audited through third parties.

Auditing has play an important role in present industrial development only after the work of audit we can know whether the statement of profit and loss and Balance- sheet have been prepared according to provision of companies act.

It is the better to study the different kind of error and fraud. The main object of audit is to detect and prevent error and fraud.

Error -

Human being are likely to commit mistake of a omission, commission and principle in maintaining books of account, we may addition, subtraction, division, multiplication. mistake may also be omitted in carrying forward total from one page to another page, posting from subsidiary book to ledger account and some time capital expenditure may be recorded as revenue expenditure or revenue expenditure may be recorded as capital expenditure.

These mistakes are likely to be committed in the books of accounts.

There are four type of error:-

1. Error of omission:- It is classified into two part

a) Error of complete omission:- under this error transaction escape from being recorded. The accountant forget to record these transaction in the subsidiary book or in the journal, omission to record book may be sold are recorded in the purchase book or sales return book ,purchase be recorded in sales book or purchase return book.

b) Error of partial omission : In case of partial omission transactions are recorded in debit side of an account in respect of their credit side.

2. Error of commission: These error may be regarding wrong totaling of and wrong amount are transferred one book to another book in the ledger book. These error are also concerned with error in calculation and generally the accountant reconcile them but sometime this error be managed by other items.

this error take place in the following form:

a) Recording wrong amount in the subsidiary books.

b) wrong totaling of subsidiary book.

c) Posting wrong amount in the ledger account.

d) Posting on the wrong side of ledger account.

e) Incorrect balancing of ledger account

3. Error of principle: - sometime errors are emitted due to incomplete knowledge of accounting. this type of error arise from the wrong entry of

the purchase book in behalf of purchase of machine or wages for construction of building are recorded in wages books.

4. Compensating error: there may be certain case where the effect of an error maybe naturalized by any other error.

#Duties of an editor regarding error

Regarding error auditor have following duties to their work it is common to commit error of omission, error of commission and error of principle. in maintaining books of accounts some error by which trial balance is uneffective.

In fact, an auditor is appointed to detect this type of error. on the other hand there are some error in presence of which trial balance is not affected. In the situation auditor inform to client regarding such type of error. In such case the auditor should do the work of accountant also for which he will be pay some extra money as remuneration.

An auditor is not supposed to make trial balance. He is appointed for examination of the books not to prepare account if the accountant are not prepare trial balance properly then this work is done by auditor.

The main duties of an auditor regarding error and fraud is :-

- a) To detect error.
- b) He should work as a detector.
- c) He should do his work honestly.
- d) He should create moral pressure on employee.
- e) He should give suggestion to prevent error.

- f) He should unnecessary doubt on employee.
- g) To detect error he should be e based on routine checking.
- h) To follow the regulation of audit act he should protect the interest of his client.

#Fraud

Fraud means false representation made intentionally believe in truth to defraud somebody.

In other word fraud is an error made with fully or knowingly with a view to cheat others.

According to Dicksee ,” the primary duties of an auditor is to detect fraud. Those auditor do this work are based in their occupation

There are various type of fraud:-

1. Misappropriation without the concern of the owner:- for the point of view of the study it's can be classified with the following:

- a) Misappropriation of cash
- b) Misappropriation of assets
- c) Misappropriation of labour.
- d) Misappropriation of amenities.
- e) Misappropriation of good.
- f) Misappropriation of accounts.
- g) Misappropriation of window dressing

a) Misappropriation of cash: - misappropriation of cash means wrongful conversion of cash. it is taken the firm of actual theft, it may be made any of the following manner

i) Non recording of under recording of cash sales.

ii) Omitting to record cash received.

iii) Recording less amount of cash received than actual received.

iv) Recording factious payment of cash.

v) Cash sales recording with sales return.

vi) By making payment to fake worker.

vii) No recording of amount received from sale of scrap and newspaper.

viii) Misappropriation of cash by showing false receipt.

ix) No entry for casual receipt.

x) No entry for bad debts recovered

b) Misappropriation of goods:- when the inventory is not mention in the books of account then misappropriation of goods can be easily done. Costly and lightly goods can be easily misappropriated, it can take place in one or more than following manner:-

i) Stolen of goods from godown.

ii) No record of purchasing goods.

iii) Use of stationary for personal use, but it's purchase for the organization

c) Misappropriation of assets:- generally assets can be misappropriated by top level authority. example purchase of fridge, TV,

battery, chair for office use but its actual used for personal, and all assets are replaced with old assets.

d) Misappropriation of labour :- now a days this type of misappropriation is very famous. some important example of this category for official peon are engaged for domestic use.

e) Misappropriation of amenity :- sometime some amenity are provided some specific employee that is facility of car, telephone, watchmen but this amenity avail by those employee whom no provision is made for this

f) Misappropriation of accounts: fraud of cash or goods is also done through manipulating accounting it is more difficult to detect by the director or management because by showing more the actual profit or loss then the actual profit.