AUDITING

P SUNANDA
CONTRACT LECTURER IN COMMERCE

DEFINITION

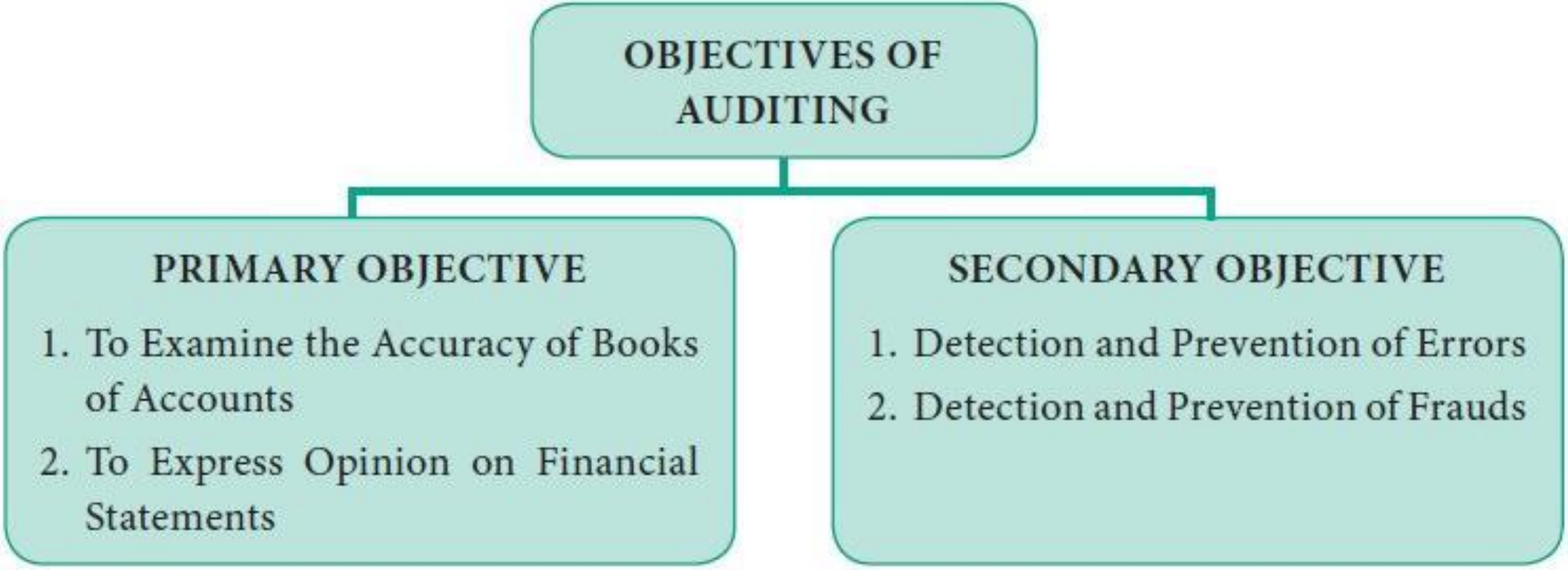
According to spicer and Pegler, “An audit may be said to be such an examination of the books, accounts and vouchers of a business as will enable the auditor to satisfy himself that the balance sheet is properly drawn-up, so as to give a true and fair view of the state of the affairs of the business, and whether the profit and Loss Accounts gives a true and fair view of profit or loss for the financial period, according to the best of his information and the explanations given to him and as shown by the books and if not, in what respect he is not satisfied”

R.B. Bose has defined as audit as “the verification of the accuracy and correctness of the books of account by independent person qualified for the job and not in any way connected with the preparation of such accounts.”

FUNCTION OF AUDITING

1. Reviewing systems and procedures of business.
2. Examining documentary evidence to establish the accuracy of recorded transaction.
3. Reviewing the system of accounting and internal control.
4. To verify the valuation and existence of assets.
5. To examine the mathematical accuracy of accounting statements.
6. To see whether the statutory requirements have been complied with.
7. Reporting as to what extent, accounts exhibit truth and fairness.
8. To make recommendations for improvement in internal control and accounting system.
9. To verify the distinction between capital and revenue items.

OBJECTIVES OF AUDITING



MAIN OBJECT OF AUDIT

1. Examining the system of internal check.
2. Checking arithmetical accuracy of books of accounts, verifying posting, casting, balancing, etc.
3. Verifying the authenticity and validity of transactions.
4. Checking the proper distinction between capital and revenue nature of transactions.
5. Confirming the existence and value of assets and liabilities.

SUBSIDIARY OBJECTS OF AUDIT

Detection and prevention of frauds

Frauds are those mistakes that are committed knowingly with some vested interest in the direction of top-level management.Management commits frauds to deceive tax, to show the effectiveness of management, to get more commission, to sell a share in the market or to maintain the market price of share, etc.Detection of fraud is the main job of an auditor.

- Misappropriation of cash.
- Misappropriation of goods.
- Manipulation of accounts or falsification of accounts without any misappropriation.

MISAPPROPRIATION OF CASH

This may be perpetrated by complete or partial omission to enter receipts of money in the cash book or by the inclusion of fictitious payments and of larger sums than have been actually paid. This may also be done through “teeming and lading” i.e., an amount received from one party is Misappropriated and subsequent collection from another party credited to the former leaving the latter’s account outstanding.This process is repeated continuously. Such frauds may be detected by a systematic, exhaustive and careful checking of the cash book with original vouchers, e.g., counterfoils of receipts, duplicate copies of cash memos, invoices, wages sheets, salesmen’s desk books, acknowledgements etc.

MISAPPROPRIATION OF GOODS

This involves pilferage of stock and is very difficult to detect, particularly in case of small pilferages, unless a strong and efficient system of stock recording and stock control is in operation showing in details every movement of goods inward or outward. For the purpose of discovering this type of fraud, gatemen's inward and outward goods books, requisitions, challans, bin cards and store ledgers should be carefully scrutinised.

FALSIFICATION OF ACCOUNTS

Accounts may be falsified through bolstering up of an insecure business by showing an artificially inflated profit in order to maintain confidence among shareholders and members of the public and to obtain fresh capital or credit.

Or it may be done by directors or managers for paying dividends which would not be payable otherwise, for securing higher sums of commission based on profit; or for disposing of their own shares at a good price before there is a collapse.

SUBSIDIARY OBJECTS OF AUDIT

Detection and prevention of errors

Errors are those mistakes that are committed due to carelessness or negligence or lack of knowledge or without having vested interest.Errors may be committed without or with any vested interest.So, they are to be checked carefully. Errors are of various types. Some of them are:

- Errors of principle.
- Errors of omission.
- Errors of duplication.
- Errors of commission.
- Compensating errors.

ERROR OF PRINCIPLE

Where the recording of the items of transactions are not done according to the Principle of Accounting, it is known to be an error of principle. These errors are not traceable from trial balance; these errors may be committed unintentionally or for the purpose of manipulation of accounts to inflate or deflate profit.

- Providing excessive or inadequate depreciation
- Where the provision for outstanding expenses or prepaid expenses is wrong
- Where revenue expenses may be treated as capital expenditure or vice versa
- Where valuation of Plant & Machinery, Stock, investment and other assets are not done according to the Principle of Accounting.

ERRORS OF OMISSION

There may be two types of omission of entry while recording the transactions in the books of accounts;

- Where transaction is totally omitted from the books of accounts, it will not affect the trial balance and the detection of such error is difficult.
  - Omission of purchase or sale from the purchase day book or the sale day book respectively.
  - Omission of outstanding or unpaid expenses.
- Examples of the transactions which are partially omitted from the books of accounts are −
  - Where total of purchase day book or sale day book omitted to be posted in purchase or sale account respectively.
  - Where payment or receipt transaction omitted to be recorded in ledger account from cash book.

ERRORS OF DUPLICATION

The detection of error of duplication is very difficult. It might be detected with proper and minute observation of accounts; for example, purchase may be recorded twice with original and duplicate copy of purchase invoice, etc. It is also possible to post the total of any ledger account twice in the trial balance.

ERROR OF COMMISSION

Error of commission occurs the entry made in the books of the original entry or the ledger account is wrong. Let us see the following examples –

- Purchase of goods for Rs. 25,000 wrongly entered as Rs. 2,500 in purchase book.
- Credit purchase from AB Company wrongly credited to BA Company’s account.
- Wrong totaling – total of purchase day book is totaled as Rs. 1,12,500 instead of 1,21,500.
- Purchase from AB Company wrongly debited to AB company account instead of crediting AB company account and debiting purchase account.

COMPENSATING ERRORS

When the effect of an error compensates with another error; it is known to be a compensating error. Such errors do not affect the trial balance; for example, total of a debit account as well as credit account totaled short by Rs. 7,500. This type of error will compensate both.

Bookkeeping vs Accounting

	Bookkeeping	Accounting
Definition	Bookkeeping is mainly related to identifying, measuring, and recording, financial transactions	Accounting is the process of summarizing, interpreting, and communicating financial transactions which were classified in the ledger account
Decision Making	Management can't take a decision based on the data provided by bookkeeping	Depending on the data provided by the accountants, the management can take critical business decisions
Objective	The objective of bookkeeping is to keep the records of all financial transactions proper and systematic	The objective of accounting is to gauge the financial situation and further communicate the information to the relevant authorities
Preparation of Financial Statements	Financial statements are not prepared as a part of this process	Financial statements are prepared during the accounting process
Analysis	The process of bookkeeping does not require any analysis	Accounting uses bookkeeping information to analyze and interpret the data and then compiles it into reports
Bookkeepers and Accountants	Basically there are two types of bookkeeping - Single entry and double entry bookkeeping	The accounting department does preparations of a company's budgets and plans loan proposals

THANK YOU