**Auditing Concepts UNIT 1**

**Q 1.What is Auditing?**

Ans. Auditing is an official financial inspection of a company or its accounts. It is governed by professional standards, completed by individual auditor or firms of auditors independent of the process being audited.

**Q. What is the difference between Accounting and Auditing?**

Ans.1) Accounting is the recording of transactions in books of accounts and to prepare final accounts whereas auditing is the examination of accounts and financial statements and to report of their truthfulness and fairness.

2.The main objective of Accounting is to prepare financial statements whereas the main objective of auditor is to give an opinion about the truthful and fairness of the financial statement.

3. Accounting is done by the employees of the organization where as an independent person who is an auditor is appointed as per the provisions.

4.Accountant is responsible to the management where as auditor is responsible the shareholders.

5.Accounts and financial statements are not reliable until audited whereas audited accounts and financial statements are reliable.

**Q2.Describe the nature of Audit**

Ans : The nature of audit can be described as follows

1.It is a systematic through and independent examination of books of accounts.

2.An audit enables an auditor to express an opinion whether the financial statements are true and fair or not.

3.The scope of audit is extended to all commercial and non commercial organization.

4.The auditor has to satisfy himself with the authority of the financial statements and reports

5.the opinion of the auditor on the financial statement is communication to the shareholders through audit report.

**Q3. What are the basic principles governing an Audit?**

Ans. Some important principles governing Audit are:

1)Principle of Integrity: The auditor is expected to be straight forward, honest and sincere in performing his duties.

2)Principle of Objectives : The auditor should perform his work objectively.He must be fair and should not allow prejudice or bias to override his objectivity.

3)Principle of Independence: Independence of auditor means that the judgement of the auditor is not subject to the wishes or directions of any authority of the entity(auditee) or any party having an interest in the entity.

4)Principle of Confidentiality: The auditor should maintain the confidentiality of information known to him in the course of his work and should not disclose any such information to a third party.

5)Principle of personal attributes: An auditor must be skilled and competent to be appointed as auditor.

**Q4. What are the objectives of Auditing?**

Ans. The main objectives of Audit are discussed below:

A)PRIMARY OBJECTIVES: The primary objectives are:

1.Fairness of Statements: The purpose of auditing is to determine the fairness of statements.

2.Prescribed Laws: The purpose of auditing is to check that prescribed laws have been followed in the preparation of financial statement.

3.Accounting Policies: The purpose of auditing is to examine the accounting policies.

4.Independent Opinion: The purpose of the audit is to express an impendent opinion.

B)SECONDARY OBJECTIVES: The secondary objectives are as follows:

5)Detection of Errors: The auditor can use ways and means to find out errors in the accounting record.

6)Detection of Frauds: The purpose of auditing is to prevent frauds.

7)Prevention of Errors: The errors can be prevented through effective internal check.

8)Prevention of Frauds: The effective internal check is a usefull tool to prevent frauds.

C)SPECIAL OBJECTIVES : The special objectives of auditing are

9)Management Audit : The purpose of Management Audit is to access the performing ,review the organizational structure and suggest the best course of action.

10)Tax audit : The purpose of auditing is to satisfy the taxation officers.

11)Social Audit : The purpose of the social audit is to measure social performance of the business.

12)Propriety Audit : The purpose of propriety audit is to examine the proper use of money. There is a requirement of economic use of resources in the best interest of business.

13)Cost Audit : The purpose of the cost audit is to verify the correctness of cost accounts. The cost audit can help the management to improve the efficiency in doing business.

14) Operation Audit : the purpose of operation audit is to prevent misuse of resources. There is need of intelligent use of resources for optimum output with lowest possible cost.

15) Bid offer : The purpose of audit is to determine the real value of the business for bid offer. The bidders can offer bid price on the basis of such price. The audited accounts survey as a guideline to arrive at a certain decision.

16) Purchase Consideration : The purpose of the audit is to determine the purchase price of the business. The audited accounts determine the value of assets and liabilities. The buyers and sellers can make a deal to amalgamate or merge business.

17) Loan : The bankers rely on audited accounts for the supply of money. The audited accounts are legal requirements of the loan facility.

18) Admission : The purpose of the audit may be an admission of a partner .The audited accounts can provide information to new as well as old partners.

19) Profits : The purpose of the audit may be checking variations in profits .The flocculation in profits can be analyzed by an expert auditor.

**Q5.What are the different types of error ?**

Ans : Errors are broadly divided in to two types

1. Clerical Error
2. Error of Principal

The clerical errors may be of the following types

a)Error of omission

b) Error of commission

c)Compensating Error

These are explained bellow

1. Clerical Errors : Clerical Errors are those errors which are committed by the accounting staff in recording ,posting,totaling,balancing etc.

The different types of clerical errors are explained bellow .

a)Errors of omission : Errors of omission arise due to clerical mistake. If transaction has not been recorded, fully or partially ,it is an example of error of omission

b) Error of commission : If an item is is incorrectly recorded in the journal or posted in the ledger, it is an error of commission .It arises through negligence while recording transactions in the books of accounts.

c)Compensating Error : when an error is counterbalanced or compensated by any other error or errors in such a way that the adverse effect of one on debit or credit side is neutralized by that off another credit or debit side ,it is called compensating error.

2)Error of Principal : Error of Principal arise of of a disregard for the principal of accountancy. The following are some of the examples of such type of error.

 a) Incorrect Allocation of expenditure between capital and revenue

 b) Posting of one revenue item to another revenue account.

 c)Posting a revenue item to a personal account

 d) Non application of accounting principles in the valuation of assets.

**Q6 : What are the different types of frauds?**

Ans : Fraud means misrepresentation or entry made intentionally or without believe in its truth. Fraud is committed with a view to defraud somebody or to obtain and illegal advantage or personal gain. There are mainly 3 types of frauds. They are

1)Misappropriation or embezzlement of cash : Cash may be misappropriated by

 I) The theft of Cash receipts and patty cash

 II) The theft of cheques and other negotiable instruments.

 III) Payments made to factious creditors or workmen.

2) Misappropriation of goods : This type of fraud is possible for less bulky but valuable goods. Valuable goods may be stolen by the employees or workers from the business.

3)Manipulation of Accounts : Manipulation of Accounts is undertaken to conceal the true position of the concern. It is generally perpetrated by the managers, directors or other responsible officials to get undue benefit.

Q)Describe auditor’s duty regarding detection and prevention of errors and frauds.

Ans : The duty of an auditor to detect errors and frauds to arrive at a decision for the report and to )

1. It is desirable that the auditor should exercise reasonable care and skill so that he may detect errors and frauds. The auditor cannot check every item of the financial transaction and he is required to reply on the advances in many cases which may not be accurate or correct. An auditor should exercise almost skill and diligence in scrutinizing accounts thoroughly before certifying them. Whenever he finds a loophole, he must be more vigilant in such situation. At te same time he should not have a presupposition that there are errors and frauds. An auditor is a watch dog ant not a bloodhound as was observed by the learned judge in “KINGSTON COTTON MILLS CO. CASE”. The auditor doesn’t guarantee that once he has signed the report on the account, no fraud exist. If he has conducted the audit by applying due care and skill in consonance with the professional standards expected of him ,the auditor would not been held responsible for not having discovered that fraud.
2. The auditor is not an officer of the organization whose accounts are under audit. As such, he has no authority to introduce remedial measures for the prevention of errors and frauds. The position of the auditor in regard to detection and prevention of errors and frauds can be summarized as follows :
3. The auditor is not liable for any subsequent discovery of errors and frauds in financial information, provided he carried out his duty according to generally accepted auditing practices
4. It is the responsibility of management to prevent errors and frauds.
5. If he discovers any errors or frauds he must ensure errors are corrected and effect of fraud is properly reflected.
6. The auditor need not sniff for errors and fraud. If he smells he should be alert to dig it out and should inform properly to the concern authority.

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