Auditing

Principles and Techniques

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FOREWARD

Technologies thought to protect investors against frauds and help auditors identify those activities could actually assist executives in committing fraud, or even learn to commit the frauds themselves. An auditor's role is to conduct an audit in such a manner as to obtain reasonable assurance that the financial statements, taken as a whole, are free from material misstatements, whether due to fraud or error. It is mainly management's role to place a strong emphasis on fraud prevention, which can severely reduce opportunities for corporate misdeeds.

Dr. Nuzhat Sadriwala, the writer of this book entitled, AUDITING: PRINCIPLES & TECHNIQUES, is a profound thinker and writer of many accounting and auditing articles and research papers, besides being a teacher and a very sensitive human being. What I found in this book that, it displays audit is not just a formality, it is a necessity to protect your business and encourage it to thrive. Maintaining an effective system of internal controls is vital in achieving a company's business objectives, obtaining reliable financial reporting on its operations, preventing fraud, preventing misappropriation of its assets and minimizing its cost of capital.

Dr.Sadriwala, besides being a lovely professor, her abilities in communicating the things is marvellously exemplary. This is quite evident in this book .In short, this book is an amalgamation of all her abilities, perceptions, understandings and her sincere efforts of accounting. Her personality, thinking and expressions match each other, i.e. there is a tremendous co-ordination between what she thinks, what she says and what she acts. The present book is a live example of all these.

I strongly recommend its purchase to get a strong understanding of what audit is. The book look at auditing from the very basics and by the end of this book, all your questions regarding fraud and its prevention would be answered. You will surely gain a deeper sense of quirkiness, the subtleties and complexities of the accounting world as none of us is perfect and we all learn and improvise. I wish Dr.Sadriwala every success in her life.

December 18, 2019

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Preface

I feel great pleasure in presenting my book **Auditing: Principles and Techniques** before the readers. The book is an attempt to present the whole subject in a simple, lucid and comprehensive manner to better understand the complex subject matter.

Auditing is one of the most dynamic subject. The Ministry Of Company Affairs has replaced the old Companies Act 1965 with new Companies Act 2013. The ICAI has revised most of the standards on auditing. Therefore, the students are expected to have an expert knowledge of these SAs and their pronouncements.

Auditing is a theoretical as well as practical subject having practical utility and requiring practical approach affecting various procedures of auditing. The latest provisions of the companies act 2013 and other acts relating to audit and various views expressed and the recommendations made by professional bodies of ICAI and ICMA on different aspects of auditing and including standards on auditing(SAS) have been incorporated in the chapters.

The book is intended to meet the needs of the students studying in undergraduate and post graduate classes of various universities viz. B. Com, BBA and M. Com. The book is also useful for professional and competitive exams for which the subject matter relating to auditing has been in the syllabus.

Every effort has been made to make this book application oriented, a large number of questions have been incorporated at the end of every chapter. My effort will amply awarded if this book proves to be useful to the students.

I earnestly hope that the book will be of great use to the teachers as well as the students and may provoke a warm response

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from them. Reader's suggestion for the improvement of the book are most welcome and will be duly acknowledged.

Dr. Nuzhat Sadriwala

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AUDIT : AN INTRODUCTION



Origin of Audit

The term audit is derived from the Latin term 'audire,' which means to hear. In early days an auditor used to listen to the accounts read over by an accountant in order to check them Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt. Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Arthasashthra by Kautilya detailed rules for accounting and auditing of public finances. The original objective of auditing was to detect and prevent errors and frauds. Auditing evolved and grew rapidly after the industrial revolution in the 18th century With the growth of the joint stock companies the ownership and management became separate. The shareholders who were the owners needed a report from an independent expert on the accounts of the company

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managed by the board of directors who were the employees. The objective of assessment shifted and assessment was expected to ascertain whether the accounts were true and fair rather than detection of errors and frauds. In India the companies Act 1913 made assessment of company accounts compulsory With the increase in the size of the companies and the volume of transactions the main objective of assessment shifted to ascertaining whether the accounts were true and fair rather than true and correct. Hence the emphasis was not on arithmetical accuracy but on a fair representation of the financial efforts The companies Act.1913 also prescribed for the first time the qualification of auditors The International Accounting Standards Committee and the Accounting Standard board of the Institute of Chartered Accountants of India have developed standard accounting and auditing practices to guide the accountants and auditors in the day to day work The later developments in auditing pertain to the use of computers in accounting and auditing. In conclusion it can be said that auditing has come a long way from hearing of accounts to taking the help of computers to examine computerised accounts.

Introduction of Audit

An audit is a systematic and independent examination of books, accounts, statutory records, documents and vouchers of an organization to ascertain how far the financial statements as well as non-financial disclosures present a true and fair view of the concern. It also attempts to ensure that the books of accounts are properly maintained by the concern as required by law. Auditing has become such a ubiquitous phenomenon in the corporate and the public sector that academics started identifying an "Audit Society".The auditor perceives and recognises the propositions before them for examination, obtains evidence, evaluates the same and formulates an opinion on the basis of his judgement which is communicated through their audit report.

Audits provide third party assurance to various stakeholders that the subject matter is free from material misstatement. The term is most frequently applied to audits of the financial information relating to a legal person. Other areas which are commonly audited include: secretarial & compliance audit, internal controls, quality management, project management, water management, and energy conservation.

As a result of an audit, stakeholders may effectively evaluate and improve the effectiveness of risk management, control, and

the governance process over the subject matter. But the word, audit, had a wide usage and it now means a through scrutiny of the books of accounts and its ultimate aim is to verify the financial position position disclosed by the balance sheet and the profit and loss account of a company.

Definitions of Audit

It is a bit difficult to give a precise definition of word audit in a word or two, originally its meaning and use was confined merely to cash audit and the auditor had to ascertain whether the person responsible for the maintenance of accounts had properly accounted for all the cash receipts the payment on behalf of his principle. The following are the some of the definitions of audit given by some writers:

Spicier and Pegler

An audit is such an examination of the books, accounts and vouchers of a business as it enable the auditor to satisfy that the Balance Sheets 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 the profit or loss for the financial period according to the best of his information and explanations given to him and as shown by the books, and if not, in what respects he is not satisfied.

Montgomery

Auditing is a systematic examination of the books and records of a business or other organization, in order to ascertain or verify and report upon the facts regarding its financial operation and the result thereof.

Lawrence R. Dicksee

An audit is an examination of records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they relate. In some circumstances it may be necessary to ascertain whether the transactions are supported by authority.

F.R.M De Paula

An audit denotes the examination of Balance sheet and profit and loss accounts prepared by others together with the books, accounts and vouchers relating there to in such a manner that the auditor may be able to satisfy himself and honestly report that in

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his opinion, such Balance sheet is properly drawn up so as to exhibit a true and correct views of the state of affairs of the particular concern according to the information and explanations given to him and as shown by the books of acconts.

A.W. Hanson

An audit is an examination of such records to establish their reliability and the reliability of statement drawn from them.

R.B. Bose

Audit may be said to the verification of the accuracy and correctness of the books of accounts by independent person qualified for the job and not in any way connected with the preparation of such accounts.

Taylor and Perry

An audit is an investigation by an auditor into the evidence from which the final Revenue Accounts and Balance sheet or other statement of an organization have been prepared, in order to ascertain that they present a true and fair view of the summarized transactions for the period under review and of the financial state of the organization at the ending-date, so enabling the auditor to report thereon.

International Auditing Guidelines used to define Audit as:

"An audit is the independent examination of financial statement or related 'information of an entity', whether profit oriented or not and irrespective of its size, or legal form when such an examination is conducted with a view to express an opinion thereon".

This definition comprises on:

1. Independent Examination:- It means that auditor (The person appointed by company with the approval of shareholders to conduct audit) must be independent and he has all the written or express powers to examine any document for evaluation. Management of the company must provide him all the details for proof.

2. Financial Statement:- Basically auditor evaluate the company on the basis of financial statements; Like he check out that whether F/S are being produced in accordance with local laws (Companies laws, Tax laws, etc.) and international laws (IFRS, IAS) etc.

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3. Nature of Entity:- The audit may be of profit oriented business or not for profit entity. Profit making business like companies working in the field of ; Oil and Gas, Aviation, Telecom etc. and NPO (Not Profit Organisation) like working in the field of; Education, Sports, Charity and religious activities.

4. Opinion:- The purpose of appointment of auditor is to assure to shareholders and stakeholders (Banks, employees, Supplier, Govt...) that company is complying with rules and regulations and their is no evidence for any fraud and misstatement in documentation. So auditor assess the audit on the basis of certain tests like by sampling or by checking some important records about assets or payments on random basis. Auditor always give his opinion, because nobody can find out clear crystal performance of business but on certain pre-determined assumption he gives his written opinion whether financial statements are giving true and fair view or not.

Therefore, audit is the examination or inspection of various books of accounts by an auditor followed by physical checking of inventory to make sure that all departments are following documented system of recording transactions. It is done to ascertain the accuracy of financial statements provided by the organisation. Audit can be done internally by employees or heads of a particular department and externally by an outside firm or an independent auditor. The idea is to check and verify the accounts by an independent authority to ensure that all books of accounts are done in a fair manner and there is no misrepresentation or fraud that is being conducted. All the public listed firms have to get their accounts audited by an independent auditor before they declare their results for any quarter.

An audit is 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. This definition has the following implications:

(a) Audit is independent examination.

(b) examination is of financial information when the objective is to express an opinion.

(c) requirement of audit applies in case of every entity, whether

profit oriented or not (commercial entities or NGOs), whatever is the business size of entity (Small Size entity or large size entity), whatever is the legal form of the entity (proprietor, partnership or company).

Difference Between Book-Keeping, Accountancy and Auditing

The book-keeping, accountancy and auditing are different from each other in their meaning, scope, advantages, interest served, recording, analysis and reliability. However, the difference between these can be expressed as follows:

Book-keeping: May be defined as the act of recording financial transactions of an independent unit in suitably ruled books, whether maintained manually or electronically, kept for the purpose of each accounting cycle.

Book-keeping is concerned with maintaining a regular, correct and automatic record of day to day financial transactions of economic unit. It is a work of a more or less mechanical nature and does not require knowledge of the principles of accounting. Bookkeeping includes :

i. entering the financial transaction in various books

ii. summarizing the same in the relevant ledger accounts,

iii. casting such accounts and striking the balance,

iv. proving the arithmetical accuracy of ledger, and

v. providing financial data for the preparation of financial statements.

Auditing: May be defined as the analytical and critical examination of the books of accounts checking and verification of evidence in support of entries appearing in the books of accounts, and ascertaining the authenticity of the assertions made in the financial statements. Auditing is a systematic examination of the financial statements, to determine how far they have adhered to the management policies and generally acceptable accounting principles.

Auditing is quite different from book-keeping and accountancy and is not concerned with the writing up of books of accounts or the preparation of financial statements.

Concisely: Bookkeeping, as the name implies, is the writing up and keeping of books of accounts (both subsidiary and main).

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Accountancy, refers to the preparation of periodical financial statements for presentation to owners and others. Auditing, is the examination, verification, valuation and giving professional opinion on the books, records and financial statements prepared by the enterprise.

Concluding

(a) Bookkeeping begins simultaneously with the introduction of capital, whether in cash or in kind of partly in each form and comes to an end with the return of capital of the owner;

(b) Accountancy begins where bookkeeping ends.

(c) Auditing has nothing to do with bookkeeping and accountancy but is a critical and investigative examination of financial data collected, classified and summarized according to proper and generally accepted principles.

Thus, an auditor should have the proper knowledge of accounting principles. That is why he should be a chartered Accountant. He has to express his impartial opinion in his report which he can not give unless he satisfies himself completely with the proper recording of transactions. Thus, auditing is based on accountancy and not accountancy on auditing. An auditor must be well familiar with the principles and practical aspects of accountancy but it is not necessary for an accountant to be an expert in the audit work. The following table makes the distinction clear among book-keeping accountancy and Auditing.

(a) Book-keeping

1. Journalizing. (Recording & Balancing)
2. Posting into Ledger. (the Practical Part)
3. Totalling of different accounts in the Ledger, and
4. Balancing,
5. Checking the work of the Book-keeper.
6. Preparation of Trial Balance,

(b) Accountancy

7. Preparation of Trading & Profit & laws account, (summary and Analysis)

8. Preparation of Balance sheet, (Theoretical part)

9. Passing entries for rectification of errors and making adjustments,

(c) Auditing

10. Checking the work done by the accountant. (Examination of Records) (the Analytical part)

Every businessman maintains accounts but he invariably thinks that auditing is a luxury. Auditing of accounts is a sheer wastage of time and money. Let us have a glance on this thinking.

Accounting is a Necessity

A businessman considers accounting as a necessity and expenditure on accounting is justified on the following grounds :

1 A businessman cannot remember all the transactions for a long time unless they are recorded.

2 Businessman wants to know the correct trading results and his financial position which is not possible unless proper records of all transactions are kept and financial statement (P&L account and Balance Sheet) are prepared.

3 Management of an entity takes several important decisions which are based on the financial statements and other records.

4 Written accounting records are a source of evidence in a court of law.

5 Written records may facilitate a comparative study of his financial position between two periods and also between various firms.

6 Tax liability is calculated on the profit/loss revealed by the financial statement.

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