INTRODUCTION TO AUDITING

MEANING AND DEFINITION OF AUDITING

- 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.

ANALYSIS OF DEFINITION

- Audit is an independent examination of financial statements
- The entity may be large/small, profit oriented/ NPO(Non-profit oriented) like an NGO
- It may have any legal form
- The basic objective of an audit is to express an ***OPINION*** on the financial statements.

POINTS TO REMEBER

- The accounts are drawn up as per the entries in the books of accounts
- The entries are supported by **documentary evidence.**
- The information is properly conveyed by the financial statements
- The Financial Statements give a **true and fair** view of the operational results and assets and liabilities.

OBJECTIVES OF AUDIT

- As per SA-200 “Overall Objectives of the Independent Auditor”, in conducting an audit of financial statements, the overall objectives of the auditor are:

a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and

b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor’s findings.

OBJECTIVES OF AUDIT

Objectives of an Audit

To obtain reasonable assurance

Ensure financial statements as a whole are free from material misstatement

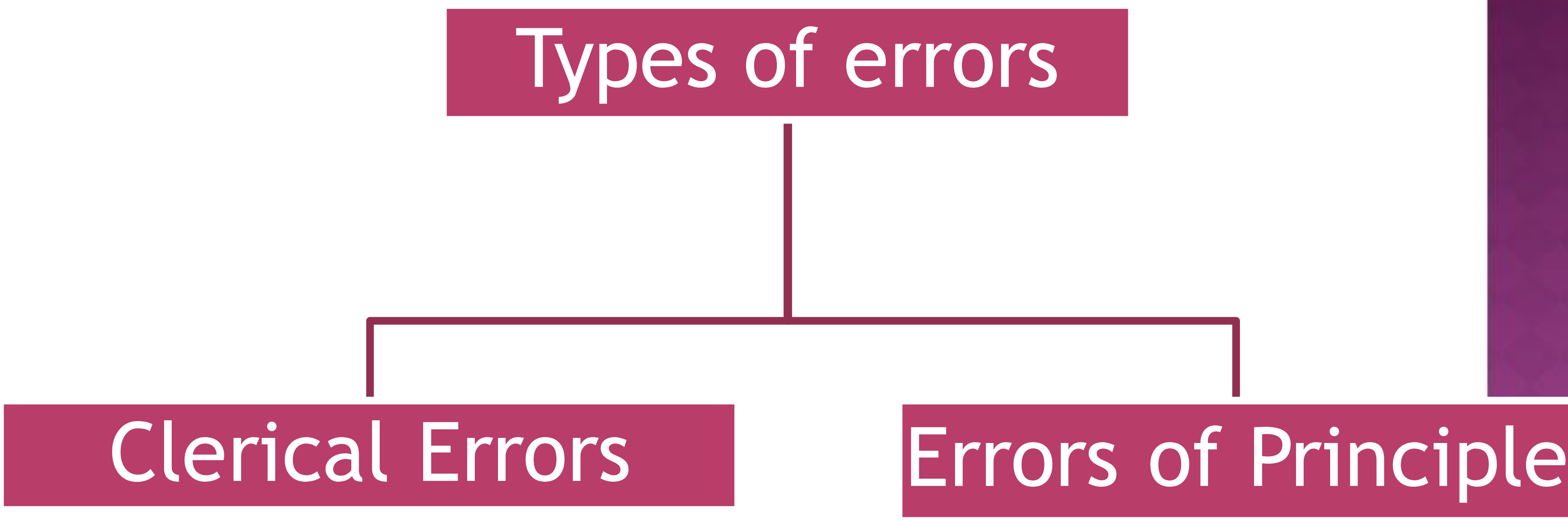
To report on the financial statements

communicate as required by the SAs

ERRORS & FRAUDS

- An error is an unintentional mistake in the financial statement which may be material or immaterial.
- Fraud is an intentional misstatement in the financial statements. Frauds are very serious and it is difficult to detect frauds as compared to errors.
- SA 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” defines a fraud as “an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage”

TYPES OF ERRORS



CLERICAL ERRORS

1) Omission:- Any transaction is omitted to be recorded

   a) Partial

   b) Total

2) Commission: Total mistake, wrong account/amount, mistake in carrying forward totals

3) Duplication: Transaction repeated .. No effect on tallying the trial balance

4) Compensating: One mistake compensated by the other.

ERRORS OF PRINCIPLE

- These errors are related to non-compliance of accounting principles
- For example:
- 1) Incorrect differentiation in capital and revenue items
- 2) Wrong application of valuation principles

TYPES OF FRAUDS

Types of frauds

- Misappropriation / employee fraud
- Manipulation of Financial Statements/ Information

  Management fraud

MISAPPROPRIATION

- Misappropriation
  - Misappropriation of cash
    - Suppressing cash receipt
    - Inflating cash payments
  - Misappropriation of goods
    - 1) First goods are misappropriated & then sold
    - 2) Goods first rejected as inferior & then sold off
    - 3) Goods purchased do not reach the godown/factory

MISAPPROPRIATION OF CASH

- Slicing small amounts from cash receipts
- Teeming & Lading
- Deferring the recording of cash receipts
- Inflating the expenses amount
- Siphoning amount received from customers
- Giving advances to other employees without proper authorisation from the management

MISAPPROPRIATION OF GOODS

- 1) First goods are misappropriated & then sold
- 2) Goods first rejected as inferior & then sold off
- 3) Goods purchased do not reach the godown/factory

- ***<u>Stealing in small quantities also known as pilferage</u>***

MANIPULATION OF FINANCIAL STATEMENTS/ INFORMATION

Fraud can be committed by management overriding controls using such techniques as:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
- Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.

- Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
- Altering records and terms related to significant and unusual transactions

MANIPULATION OF FINANCIAL STATEMENTS/ INFORMATION

- Also known as 'Window Dressing' it is the abuse of authority by people at the helm of affairs.

Watch the following videos

https://www.youtube.com/watch?v=e5qC1YGRMKI

https://www.youtube.com/watch?v=i-IKVOYEcPQ

- To achieve the objectives either of the following is resorted to:-
- A) Showing higher profits
- B) Showing higher losses

SHOWING HIGHER PROFITS

- To attract investors
- To get more remuneration
- To manipulate stock prices
- To get loans etc from banks / Financial Institutions
- To sell their own shares at a higher price

SHOWING HIGHER LOSSES

- To get tax benefits
- To pay lower dividend
- To create secret reserves
- To pay less bonus to workers
- To purchase shares at a lower price

CONCLUSION

- Misstatements in the financial statements can arise from either fraud or error.
- The differentiating factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

As per SA 240 the primary responsibility for the prevention and detection of fraud rests with management. An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error

SOURCES

- ICAI Intermediate Study material- paper 6 Auditing and Assurance.
- Auditing & Assurance (Auditing) | Study Material- CA Pankaj Garg, Taxmann Publications.
- A Hand Book of Practical Auditing- B.N Tandon, S Sudarsnam & S Sundharababu- S. Chand Publishing.