Chapter: 2nd

MEANING AND DEFINITION OF ERRORS

DEFINITIONS:

Error refers to unintentional mis-statements or mis-descriptions in the records or books of accounts by the books keepers. In other words, they are unintentional mistakes arising on account of negligence or ignorance. Errors may be basically of two types:

(a) Principal Errors and (b) Clerical Errors

(a) Principal Errors and: these errors arise generally when the principals of accountancy are not observed while recording a transaction. For instance a capital expenditure is recorded as revenue expenditure or vice versa. Such errors are difficult to detect as the Trial Balance tallies inspite of such errors.
Basically it arises on account of ignorance of accounting principles. Following are the examples of principles errors:

(1) Wages paid for installation of plant and machinery is recorded as wages paid to workers
(2) Revenue receipt is recorded as a capital receipt

(b) Clerical Errors – these errors arise on account of negligence of the accounting staff. They are called technical errors clerical errors may be further divided as errors of omission, Errors of Commission, Duplicating Errors and Compensating Errors.

TYPES OF ERRORS

i. Error of Commission

It includes posting errors, casting errors and totaling errors. For example ale to A has been recorded in B's A/c, it is a posting error or it is recorded in A's A/c but the amount is wrongly recorded. Similarly the balance of Rs.510 is carried forward as Rs.501, and then it is a casting error. Certain errors will not affect the trial balance for example posting in a wrong account will not affect the trial balance but if there is a totaling error or a casting error then the trial balance does not agree.

ii. Error of Omission

In the process of recording the accounting clerk may omit a transaction from recording either fully or partially. If a transaction is fully omitted, then it will be difficult to trace out, as both the debit and the credit are missing and the trial balance will tally in spite of these errors. However if a transaction is partly omitted, then only one aspect of the transaction is recorded. In this case it is easier to locate such an error.

iii. COMPENSATING ERROR

An error which is counter balanced by another error, so that it is not disclosed by the trial balance. It may or may not affect profit. If both original and compensating errors arise in revenue accounts, profit will not be affected, but if
One arises in a revenue account and other in an asset or liability account, trial balance will agree, but profit will be incorrectly stated. It arises in various ways, most frequently in casting, e.g., cast of expenditure account may be
Rs.96,000 too much, profit and asset being thereby shown improperly.

RISK OF FRAUD AND ERROR IN AUDIT

1. Internal Control Faults: Weaknesses in the design of internal control system and non-compliance with laid down control procedures, e.g. a single person being responsible for receipt of all pasts/ mails and marking it ti the relevant secions or two persons responsible for receipt of all posts/ mails but the same is not followed in the practice.

2. Doubts about the integrity or competence of the management,

e.g. domination by one person, high rate of employee turnover, frequent change of legal counselsof Auditors, significant and prolonged understaffing of the accounts department, etc.

3. Unusual pressures within the entity, e.g. industry is doing well but the Company's performance is poor, heavy dependence on a single line of product, inadequate working capital, need to show more profit to support the share market price, etc.

4. Unusual transactions e.g. transactions with related parties, excessive payment for certain services to lawyers, etc.

5. **Problems in obtaining sufficient and appropriate audit evidence,**

E.g. inadequate documentation significant differences between the figures as per accounting records and confirmation received from third parties. Etc.

ACCOUNTING CONCEPT RELEVANT TO AUDITING

A. Going concern concept:

- It is assumed that a business organization will continue its operations for unlimited future periods. It will not be liquidated; continuously performs its business.
- According to going concern concept, the value of assets is shown in the B/S and the cost of an asset is not treated as expense at the time of purchase of the asset.

B. Historical Cost Principle

- Cost principle should be borne in mind when reading financial statements. Under this principle all Assets purchased are recorded at cost and appear on the statements at cost.

C. Conservatism Convention

- Under this concept it is assume that, “anticipate all possible losses but no profit” i.e., the principle ignores all unrealized gains and provides for all anticipated losses. For example, the rule of ‘lower of cost or market (LCM)’ in valuing inventories is still applied.

D. Matching principles

- Under this principle, it is assumed that all expenses should be charged against revenue during an accounting period to determine the net profit.
- Examples : sales are deducted by various expense like purchase, salary, wages etc

Short notes:

MEANING OF AUDIT PROGRAMME

Audit program is nothing but a list of examination and verification steps to be applied set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions discernible in the statement of account produced for audit or on the basis of an appraisal of the accounting records of the client.

In other words, an audit programme is a detailed of the accounting records of applying the audit Procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

AUDIT WORKING PAPERS

Audit working papers are the documents which record all audit evidence obtained during financial statements auditing, internal management auditing, information systems auditing, and investigations. Audit working papers are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant auditing standards.