**Chapter - 01**

**1. Define auditing and features, explain the objectives of auditing**

* **Definition**: Auditing is the systematic and independent examination method of a company’s books and records to ensure that the financial statements present a true and fair view of its financial position and results.
* **Features of Auditing:**

1. Audit is a structured and methodical examination of accounts.
2. Conducted by an independent and qualified auditor.
3. Confirms the accuracy of Profit & Loss account and Balance Sheet.
4. Evaluates the accounting system and internal controls.

* **Objectives of Auditing**:  
  1. **Primary Objective**: To report to the owners whether the balance sheet gives a *true and fair view* of the company’s financial state and whether the profit and loss account shows the correct profit or loss for the financial year.
  2. **Secondary (Incidental) Objectives**: To detect and prevent **frauds** and **errors**.  
      i. Detection and prevention of frauds  
      ii. Detection and prevention of errors

**2. Distinguish between Error and Fraud**

* **Error**: Mistakes committed innocently and unintentionally while making entries in the books of accounts. For example, forgetting to enter a supplier’s invoice in the books.
* **Fraud**: Fake entries or Intentional misrepresentation in the books of accounts with a certain motive, usually for personal gain. Such as, Manipulating sales records to hide cash received.

**3. How fraud is committed in an organization**Fraud in an organization is any act that causes financial loss or misrepresents accounts. It can be done by employees or management and may involve theft, misuse of assets, or manipulation of records.  
Fraud can be committed in two main ways:

**Fraud through defalcation** happens when employees steal or misuse cash or goods for personal gain. The main methods are:

1. Not recording receipts in the cashbook.
2. Destroying the carbon copy/counterfoil of receipts.
3. Entering a smaller amount on the receipt counterfoil and keeping the difference.
4. Not recording casual sales like sales of scrap, old newspapers, etc.
5. Not recording cash donations received from charitable institutions.
6. Keeping the cash received from discounted bills, but still showing the bills as unpaid in the accounts.
7. Taking cash from debtors and hiding it by showing fake credits like bad debts, discounts, or sales returns in the accounts.
8. Using the ‘teeming and lading’ (lapping) method, an employee takes cash from one debtor and covers it with cash received from another debtor. This cycle continues throughout the year to hide the theft.
9. Hiding cash sales by either not recording them or recording them as credit sales.
10. By recording fictitious or fake payments

### **Fraud through Manipulation of Accounts:** This occurs when accounts are presented more favorably than they actually are. It is called window dressing because the financial statements are manipulated to show a false picture of profit, loss, or the company’s financial position.

* **Characteristics:**
  1. Usually done by top management.
  2. Does not involve stealing cash or goods.
  3. Can involve overstating or understating profits.
  4. Done with a specific objective and is relatively hard to detect.

**Circumstances that may raise auditor’s suspicion:**

1. Missing vouchers, invoices, cheques, or contracts.
2. Control accounts not matching subsidiary books.
3. Unexplained differences in the trial balance.
4. Large fluctuations in Gross Profit (G.P.) or Net Profit (N.P.) ratios.
5. Differences between balances and confirmations from parties.
6. Differences between stock records and physical count.
7. Unsatisfactory explanations from the client.
8. Overwriting of figures in records.
9. Contradictory explanations given by different parties.

### **Question 1: Types of Audit**

**Answer:**

Audits can be classified into different types based on **legislation** and **periodicity**.

### **A. On the Basis of Legislation**

1. **Statutory Audit:** Statutory audit is an audit undertaken under any specific statute or Act.It's a legally required audit, such as the audit of companies under the Companies Act.  
    **Purpose:** To ensure that financial statements give a *true and fair view* of the company’s financial position.
2. **Government Audit:** A *government audit* is conducted by the government’s auditing authorities to check the proper use of public funds.  
    **Purpose:** To ensure accountability and transparency in the use of public money.
3. **Private Audit:** A *private audit* is conducted voluntarily by non-government organizations, firms, or individuals.  
    **Purpose:** To ensure accuracy and reliability of accounts for personal or management use.

### **B. On the Basis of Periodicity**

1. **Interim Audit:** An *interim audit* is conducted between two annual audits, for a specific period such as 30th September or 31st December. During this audit, a **trial balance** is prepared and verified, and **financial statements** are drawn up for that part of the year.  
   **Purpose:** To review accounts periodically and prepare interim financial results.  
   **Note:** It is generally less independent than a statutory audit and often done by an internal auditor.
2. **Continuous Audit:** A *continuous audit* is one where the auditor’s staff checks the accounts **throughout the year** or at frequent intervals (e.g., weekly).  
    **Purpose:**
   * To maintain stricter control over accounts.
   * To detect and prevent fraud or errors early.
   * To keep the client’s books of accounts up to date.

**Chapter - 02**

### **1. Define Error and Explain the Types of Error (10 Marks)**

**Definition of Error:** Error refers to **unintentional misstatements or misdescriptions** in the books of accounts caused by negligence or ignorance.

**Types of Errors:**

1. **Principal Errors:**
   1. Occur when accounting principles are violated.
   2. Example: Treating capital expenditure as revenue expenditure.
   3. Trial balance usually still agrees, making these errors hard to detect.
2. **Clerical Errors:** Arise due to carelessness or technical mistakes. Classified as:
   1. **Error of Commission:** Wrong posting, wrong totals, or wrong balance carried forward.
   2. **Error of Omission:** Full or partial omission of transactions.
   3. **Compensating Errors:** One error offsets another, so trial balance still agrees but profit may be misstated.

### **2. Symptoms of Risk of Fraud and Error in an Organization (10 Marks)**

1. **Internal Control Weakness:**
   * Poorly designed or non-implemented control systems, e.g., one person handling all mail.
2. **Management Integrity Issues:**
   * Doubts about management competence, domination by one person, high employee turnover, frequent change of auditors/legal advisors.
3. **Unusual Pressures:**
   * Company under pressure to show profits, dependence on single product line, inadequate working capital.
4. **Unusual Transactions:**
   * Deals with related parties, excessive payments for services, unusual adjustments.
5. **Audit Evidence Problems:**Missing or insufficient documentation, major mismatches between books and third-party confirmations.

### **3. Relevant Accounting Concepts to Be Followed During Auditing (10 Marks)**

1. **Going Concern Concept:**
   * Assumes the business will continue indefinitely; assets are recorded at cost, not liquidation value.
2. **Historical Cost Principle:**
   * Assets are recorded at their original purchase price and shown at cost in financial statements.
3. **Conservatism Convention:**
   * Anticipate all possible losses but not unrealized profits; apply “lower of cost or market” rule for inventory.
4. **Matching Principle:**
   * Match revenues with corresponding expenses of the same period to calculate correct profit.

**Suggestions**

**Chapter - 1**  
1. Define auditing and objective of auditing  
2. Differences between error and fraud

3. How cash and goods deflection in an organisation.

4. Type of audit.  
  
**Chapter - 2**  
1. Explain the type of error with examples   
2. Discuss the relevant Accounting Principles/GAAP followed by auditor during auditing   
3. What are the risks of fraught and error?  
  
**Chapter -3**

1. Define internal control and explain its techniques.

2. Define vouching and what points to be checked during vouching. 12 point

3. Differences between internal and external audit

**Set - 4**

* write short note on

1. Teaming and leading.

2. Verification of assets

3. Type of audit report

4. Window drawing/ manipulation of assets

5. Vouchers

6. Auditing techniques

**Chapter 5**

* Type of audit report

1. Qualified audit report (Conditional

2. Unqualified report (highly true and false)

3. Edulens report (Highly false and wrong)

4. Disclaimer report (not any opinion from auditor)

