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AUDITING 5th SEM MATERIAL

Q1.DEFINE AUDITING? EXPLAIN ITS FEATURES AND DISCUSS ITS OBJECTIVES?

Meaning and Definition of Auditing

The word Audit is derived from Latin word "Audire" which means 'to hear'. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements. Different authors have defined auditing differently, some of the definition are:

"Auditing is an examination of accounting records undertaken with a view to establishment whether they correctly and completely reflect the transactions to which they purport to relate."-L.R.Dicksee

"Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports." - R.K. Mautz

"Auditing is the systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principles, management policies and stated requirement." -R.E.Schlosser

There are six essential **features or characteristics**of auditing are

1. Systematic process.
2. Three-party relationship.
3. Subject matter.
4. Evidence.
5. Established criteria.
6. Opinion.

1. Systematic process

Auditing is a systematic and scientific process that follows a sequence of activities, which are logical, structured, and organized.

2. **Three-party relationship**

The audit process involves three parties, that is, shareholders, managers, and the auditors.

3. **Subject matter**

Auditors give assurance on a specific subject matter. However, the subject matter may differ considerably, such as – data, systems or processes and behavior.

4. **Evidence**

Auditing process requires collecting the evidence, that is, financial and non-financial data, and examining thereof.

5. **Established criteria**

The evidence must be evaluated regarding established criteria, which include International Accounting Standards, International Financial Reporting Standards, Generally Accepted Accounting Principles, industry practices, etc.

6. **Opinion**

The auditor has to express an opinion as to the reasonable assurance on the financial statements of the entity.

Conclusion on Audit Features

Audit Features influences the objectives of the audit to refer to the
security of the information and systems, the protection of the personal data, the access to some data bases with an informational sensitive character

The basic objective with which auditing is done are:

Objectives of Auditing

The objectives of auditing are changing with the advancement of business techniques. Earlier it was only to check the correctness of receipts and payments. The objectives of the auditing have been classified under two heads:

1) Main objective

2) Subsidiary objectives

Main Objective: The main objective of the auditing is to find reliability of financial position and profit and loss statements. The objective is to ensure that the accounts reveal a true and fair view of the business and its transactions. The objective is to verify and establish that at a given date balance sheet presents true and fair view of financial position of the business and the profit and loss account gives the true and fair view of profit or loss for the accounting period. It is to be established that accounting statements satisfy certain degree of reliability. Thus the main objective of auditing is to form an independent judgement and opinion about the reliability of accounts and truth and fairness of financial state of affairs and working results.

Subsidiary objectives: The subsidiary objectives of the auditing are:

1. Detection and prevention of fraud: the one of the important subsidiary objective of auditing is the detection and prevention of fraud. Fraud refers to intentional misrepresentation of financial information. Fraud may involve:

a. Manipulation, falsification or alteration of records or documents

b. Misappropriation of assets.

c. Suppression of effect of transactions from records or documents.

d. Recording of transactions without substance.

e. Misapplication of accounting policies

2. Detection and prevention of errors: is another important objective of auditing. Auditing ensures that there is no mis-statement in the financial statements. Errors can be detected through checking and vouching thoroughly books of accounts, ledger accounts, vouchers and other relevant information.

Q2.AUDITOR IS A WATCHDOG BUT NOT A BLOODHOUND - explain

The terminology 'Watchdog' is being used for auditor in normal course of audit, where the terminology 'Bloodhound' is being used for investigator in course of investigation.

What is Audit and who is Auditor?

A person who is doing work of audit known as Auditor. As per Companies act, 2013 section 141 states that "A practising chartered accountant of India can act as an auditor"

An Audit is a process of identifying whether the results of accounting information are accurate and according to the specified norms or not. Auditing is an impartial and methodical examination of the financial statement of an entity to give an opinion on true and fair view. The word financial statement may include Balance Sheet with Notes to Accounts, Income Statement and Cash Flow Statement. The term entity refers to any organisation whether it is profit making or a charitable institution. Size and structure of the entity are also irrelevant.

Auditor is Watchdog, not a Blood Hound

The word Audit is derived from the Latin word 'Audire' which means to hear. Justice Lopes in case of Kingston Cotton Mill (1986, UK) quoted "Auditor is a watchdog, not a bloodhound." A watchdog is defined by the American Heritage dictionary as "One who serves as a guardian or protector against waste, loss, or illegal practices." A bloodhound is defined informally by the same dictionary as "A relentless pursuer."

In most audits, fraud risk will be one of several risks that are evaluated as part of the business processes under audit. If fraud is suspected, the internal auditor may be asked to perform a forensic audit specifically to detect fraud management must have a robust anti-fraud program to safeguard assets and minimize the risk of fraudulent financial reporting and misappropriation of assets.

It is the responsibility to find true and fair value of the business and gives all the details (errors and frauds) of all the business. But this task is so difficult because people tried who arise fraud in the company gives wrong information to the company. Auditor is always sincere, systematic, honest, truthful, and tactful. An auditor has a professional knowledge and expert in own field. In case of any unwanted situation. The remedial action has to come from the owner of the entity. He has to discharge his responsibility by informing about the irregularity found in the audit. Auditor needs to discharge his responsibility of forming an opinion and reporting responsibility as per SA 700-720 as well as given in the companies act,2013 under section 143(12) in prescribed form no ADT-4.

Auditor is responsible for protecting the interest of those who appointed him but the auditor will presume that servants of the company are honest and will rely on their statements. The auditor should investigate thoroughly but he is also not expected to be of suspicious mind.

Watchdogs keep watch and protect against waste and abuse. They remain aware of their surroundings, act upon suspicious behaviour or activity and may defer to the bloodhound when a relentless pursuit is necessary. Bloodhounds fixate on the scent of the animal and follow the trail through water, rain, sleet and snow until they detect the animal or collapse of fatigue. Obviously, this approach will result in additional fees, added time and client relationship management issues as they may often perceive our efforts as unnecessary, intrusive, and expensive. Judging by our definitions above, it would appear that auditors fall more into the role of a watchdog who possesses the ability to determine when a bloodhound is needed.

The auditors’ job is merely to provide a check on management by expressing an opinion as to whether the financial statements present a ‘true and fair’ view of a company’s affairs (SA 700). However, in arriving at their opinions, As per SA 240 “The Auditors responsibilities relating to fraud in an audit of Financial Statements”, auditors are required to perform their work in such a way that they will have a reasonable care, not absolute, chance of detecting fraud, Assessment of Detection risk and Management Fraud with attitude of professional scepticism. So, an auditor will not be legally liable for failing to spot material misstatements resulting from fraud, as long as he can prove that he has undertaken reasonable procedures in trying to detect it.

As such, in doing their job, auditors are heavily reliant on management, who could potentially mislead them. To cover themselves, auditors obtain a letter from management testifying that the financial statements are fairly stated. (SA 580 “Written representation from management or those who are charged with governance”)

However after 2000 we had seen many scams, in such a case the performance of auditor is becomes questionable. User of financial statements can’t rely on opinion given by the auditor. Auditor needs to plan his audit programme (SA 300) in such a way so he can find material misstatement from financial statements in his ordinary course of work. Still there is so many frauds are existing yet to come into news. This all scams are not done in a single year. It was in existing from long term and every year auditor of respected entity had given unqualified audit report.

Q3. DISCUSS ABOUT THE TYPES OF AUDIT

Types of audit

Based on ownership:**On the basis of ownership audit can be:-**

1. Audit of Proprietorship: In case of proprietary concerns, the owner himself takes the decision to get the accounts audited. Sole trader will decide about the scope of audit and appointment of auditor. The auditing work will depend upon the agreement of audit and the specific instructions given by the proprietor.

2. Audit of Partnership: To avoid any misunderstanding and doubt, partnership audits their accounts. Partnership deed on mutual agreement between the partners may provide for audit of financial statements. Auditor is appointed by the mutual consent of all the partners. Rights, duties and liabilities of auditor are defined in the mutual agreement and can be modified by the partners.

3. Audit of Companies: Under companies Act, audit of accounts of companies in India is compulsory. Chartered accountant who is professionally qualified is required for the audit of accounts of companies. Companies Act 1913 for the first time made it compulsory for joint stock companies to get their accounts audited from a qualified accountant. A number of amendments have been made in companies Act, 1956 and 2013 regarding appointment, duties, qualification, power and liabilities of a qualified auditor.

4. Audit of Trusts: The beneficiaries of the trusts may not have access and knowledge of accounts of the trust. The trustees are appointed to manage and look after the property and business of the trust. Accounts of the trust are maintained as per the conditions and terms of the trust deed. The income of the trust is distributed to the beneficiaries. There are more chances of frauds and mis-appropriation of incomes. In the trust deed as well as in the Public Trust Act which provide for compulsory audit of the accounts of the trust by a qualified auditor. The audited accounts of the trust ensure true and fair view of accounts of the trust.

5. Audit of Accounts of Co-operative Societies: Co-Operative societies are established under the Co-Operative Societies Act, 1912. It contains various provisions for the regulations and the working of these societies. Some of the states have adopted it without any change, while others have brought certain changes to it. The auditor of the Co-operative Society should have an expert knowledge of the particular act under which Co-operative society under audit is functioning. He should also study by-laws of the society and make sure that the amendments made from time to time in the by-laws have been duly registered in the Registrar’s Office. Companies Act is not applicable to the co-operative Societies. The Registrar of co-operative societies shall audit or cause to be audited by some person authorized by him, the accounts of the society once in every financial year.

6. Government Audit: Audit of government offices and departments is covered under this heading. A separate department is maintained by government of India known as Accounts and Audit Department. This department is headed by the Comptroller and Auditor General of India. This department works only for the government offices and departments. This department cannot undertake audit of non-government concerns. Its working is strictly according to government rules and regulations.

Based on Time: **On the basis of time the audit can be of following types:**

1. Interim Audit: When an audit is conducted between two annual audits, such audit is known as Interim audit. It may involve complete checking of accounts for a part of the year. Sometimes it is conducted to enable the board of directors to declare an Interim dividend. It may also be for the purpose of dealing with interim figures of sales.

2. Continuous Audit: The Continuous Audit is conducted throughout the year or at the regular short intervals of time.

"A continuous audit involves a detailed examination of all the transactions by the auditor attending at regular intervals say weekly, fortnightly or monthly, during the whole period of trading." - T.R. Batliboi

"A continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or hiss staff attends at regular or irregular intervals during the period." -R.C Williams

3. Final Audit: Final Audit means when the audit work is conducted after the close of financial year. A final audit is commonly understood to be an audit which is not commenced until after end of the financial period and is then carried on until completed.

4. Balance Sheet Audit: Balance Sheet Audit relates to the verification of various items of balance sheet such as assets, liabilities, reserves and surplus, provisions and profit and loss balance. The procedure under this audit is to follow a backward process. First the item is located in balance sheet, and then it is located in original record for the purpose of verification.

Based on Objectives: **On the basis of objectives the audit can be of following types:**

1. Internal Audit: It implies the audit of accounts by the staff of the business. Internal audit is an appraisal activity within an organization for the review of the accounting, financial and other operations as basis for protective and constructive service to the management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of control. It deals primarily with accounting and financial matters but it may also properly deal with matters of operating nature.

2. Cost Audit: Cost Audit is the verification of the correctness of cost accounts and adherence to the cost accounting plans. Cost Audit is the detailed checking of costing system, techniques and accounts to verifying correctness and to ensure adherence to the objectives of cost accounting.

3. Secretarial Audit: Secretarial Audit is concerned with verification compliance by the company of various provisions o Companies Act and other relevant laws. Secretarial audit report includes

4. Independent Audit: Is conducted by the independent qualified auditor. The purpose of independent audit is to see whether financial statements give true and fair view of financial position and profits. Mainly it is for safeguarding the interest of owners, shareholders and other parties who do not have knowledge of day-to-day operations of organization.

5. Tax Audit: Now-a-days tax audit has become very important to ascertain the accuracy of tax related documents. Tax audit mostly covers income returns, invoices, debit and credit notes and various current and fixed assets. Tax audit is an innovation of 21st century. It has added one more chapter to the practice of auditing. Tax audit ensures the validity and credibility of tax related documents.

Q4.WHAT IS CONTINUOUS AUDIT? DISCUSS THE ADVANTAGES & DISADVANTAGES OF CONTINUOUS AUDIT?

Continuous Audit: The Continuous Audit is conducted throughout the year or at the regular short intervals of time.

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Business where continuous audit is applicable:

* Where it is desired to present the account just after the close of the financial year, as in the case of a bank.

* Where the volume of the transactions is very large.

* Where the statements of accounts is required to be presented to the management after every month or quarter.

* Where no satisfactory system of internal check is in operation.

Advantages of Continuous Audit

1. Easy to quick discovery of errors

Errors and frauds can be discovered easily and quickly as the auditor checks the accounts at regular intervals and in detail. As a auditor visits the client after a month or two or so on, the number of transactions will be small and hence, the errors will be detected easily and quickly.

2. Knowledge of technical details

Since the auditor remains more in touch with the business, s/he is in a position to know its technical details and hence can be of great help to her/his clients by making valuable suggestions.

3. Quick presentation of accounts

As most of the checking works are already performed during the year, the final audited accounts can be presented to the shareholders soon after the close of the financial year at annual general meeting.

4. Keeps the client's staff alert

As the auditor visits the clients at regular intervals, the clerks are very regular in keeping the accounts up-to-date. They will see that there is no in accuracy or frauds as it would be detected by the auditor at the next visit.

5. Moral check on the client's staff

If the auditor pays surprise visit, it will have a considerable moral check on the clerks preparing the accounts as they do not know when the auditor may pay a visit to check. Moral check will be more valuable to make staff alert and careful.

6. Complete checking of all the records: Since the audit is carried out throughout the year, sufficient time is available for detailed checking. Any enquiry and doubt arising in the course of audit can be tackled in a better way.

7. Proper planning: Auditor can plan his audit work in a systematic manner. He can evenly spread his work throughout the year. It will improve efficiency of auditor.

8. Early detection of frauds and errors: The work of auditor becomes easier for detecting frauds and errors, otherwise it will involve more time.

9. Up-to-date accounts: The efficiency of account staff will increase and their work will be up-to-date and accurate.

10. Valuable suggestions: Continuous audit will help the auditor to understand the technicalities of business. This will help the auditor to make suggestions for the improvement of business..

Disadvantages of Continuous Audit:

1. Expensive: It is an expensive system as it may not suit the budget of small organizations.

2. Dislocation of routine work: Frequent visits by auditor may dislocate the smooth flow of office work.

3. Alteration of Figures: after the accounts have been audited, the figures may be fraudulently altered by the staff.

4. Losing link in the audit work: As the work is not completed continuously, the auditor may lose continuity and certain questions and inquires may be left unanswered.

Q5. WHAT IS AUDIT PROGRAMME? WHAT ARE THE ADVANTAGES & DISADVANTAGES OF AUDIT PROGRAMME?

Meaning and Definition

Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of work of examination and a set of audit procedures.

According to Megis, An audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.

According to holmes, Audit programme is a flexible planned procedure of examination. Thus audit programme is a planning of audit by auditor so that he may be able to complete his work in a diligent manner and complete the work without loss of time.

An audit program provides a basic plan for the audit team regarding the entity's business, its size, how to conduct the audit, allocation of work among team members and the estimation of time within which it should complete the work.

It contains details regarding the relevancy of evidence, materiality level, risk tolerance, measure of the sufficiency of the evidence. Thus, programs enhance the accountability of the audit team and its members for the work performed by them.

An auditor may revise the audit program if he considers it necessary due to prevailing circumstances. The size of the entity, type of business or services in which entity deals, applicable laws, the effectiveness of internal controls, and various other relevant factors, also affect an audit program.

Thus, an auditor prepares an audit program according to its scope of work. The minimum essential work to be performed is the Standard Programme. However, there is no set audit standard program applicable in all the circumstances.

Audit working papers document the activities that the audit program performs. Audit working papers support the work performed by the auditor for providing assurance that the audit was performed in accordance with all the applicable standards on auditing (SA's). It helps the auditor in the proper execution of audit work.

An audit program covers various steps of auditing in an audit program like the assessment of internal control, ascertaining accuracy and reliability of books of accounts, inspection, vouching and verification, valuation of assets and liabilities, scrutiny of accounts, presentation of financial statements, and submission of reports and related disclosures.

Advantages of audit programme:

Some of the important advantages of the audit programme are:

1. It enables the auditor to keep in touch with the work done and general progress of the work.

2. The auditor can be certain that the audit staff will cover whole of the ground.

3. It will help the audit assistants to know their duties.

4. It helps to increase the efficiency of audit assistants.

5. Fixing of the responsibility of audit assistants becomes easier.

6. It provides a check against the possibility of certain important items requiring verification which are being omitted.

7. Continuity is not lost even if the person on the duty is changed.

Disadvantages of Audit Programme:

Rigidity: There is no set standard audit program that can be applied in the case of every entity. However, programs differ for different types of entities. Every entity has its own problems. Therefore, we cannot apply for a single audit program in the case of all business entities.

Reduces the Initiative of Efficient Staff: – A program reduces the initiatives of efficient and competent staff. Thus, staff members cannot make changes in the audit plan and cannot make suggestions to it.

Audit Work becomes Mechanical: The program becomes mechanical when it ignores other aspects like internal control.

Overlooking New Areas: A program may overlook the new areas. With the change in time and technology, new problems may arise which an audit program may not consider.

Q6.WHAT IS INTERNAL CHECK? WHAT ARE THE OBJECTIVES, ADVANTAGES & DISADVANTAGES OF INTERNAL CHECK?

Meaning and Definition:

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

According to F.R. M.e paula, "internal check means practically a continuous internal audit Carried on by the staff itself, by means of which the work of each individual is independently checked by other members of the staff."

According to D.R. Davar, " Internal check is a system or method introduced with defined instructions given to staff as to their sphere of work with a view to control and the verification of their work and also the maintenance of accurate records as the ultimate aim.

According To Joseph Lancaster, "The internal check is a method of organizing the entire operations, office, warehouse, factory and the duties to the respective staff so that frauds and irregularities are impossible without collusion."

All the definitions of internal check give a common idea about system organized within the concern itself, wherein the work of one employee is automatically checked up by the other and the possibility of error or fraud is reduced to the minimum.

Objectives of internal check:

1. To exercise moral pressure over the staff.

2. To ensure that the accounting system produces reliable and adequate information.

3. To provide protection to the resources of the business against fraud, carelessness and in efficiency.

4. To distribute work in such a manner that no business is left unrecorded.

5. To allocate duties and responsibilities of each clerk in such a way that he may held responsible for particular fraud or error.

6. To increase the efficiency of clerks because the allocation of duties is based on the principle of division of labour.

7. To detect errors and frauds easily if it is committed, because in an efficient internal check system, there is a provision for independent checking.

Advantages of Internal Check:

1. Proper division of work: internal check entails a proper and rational distribution of work among the members of staff of the enterprise keeping in view their individual qualifications, experience and area of specialization.

2. Detection of errors and frauds: since no individual worker is allowed to handle a job completely from the beginning to the end, and the work of each clerk is automatically checked by the other, this helps in the early detection and discovery of errors and frauds.

3. Increased efficiency coupled with economy: A good system of internal check increases the efficiency of work among the staff and leads to overall economy.

4. Convenience to auditor: where an organization is operating the system of internal check, the statutory auditor may conveniently avoid detailed checking of the transactions. He may apply a few tests here and there and can relieve himself from detailed checking.

5. Accuracy of the accounts can be relied upon: If there is a good system of internal check the owner of the concern may rely upon the genuineness and accuracy of the accounts.

6. Increase in Profits: overall efficiency and economy in operations result in more profits- thus ensuring larger dividends for the owners or shareholders

Disadvantages of Internal Check

Depending on each other proves fatal in the quick disposal of the work. if one person is absent, the day-to-day work will be seriously disrupted. Following are some of the disadvantages of a system of internal check:

1. Costly for small business: A system of Internal check system quite expensive especially for small business houses.

2. Quality is sacrificed for Promptness: In an internal check system quality of work declines because the clerks of the business attach greater importance to become quick and do not care if in the process their work gets substandardised.

3. Carelessness among high officials: The possibility of some of the responsible and high officials being complacent, increases as they believe, though not always rightly, that under a sound system of internal check nothing can go wrong.

4. Disorder in the working of a business: In the absence of a proper organized system of internal check there will be chaos and disorder in the working of business.

5. Risky for an auditor: If the auditor does not apply tests and procedure his own and if he relies on the output of the system his work cannot be free from irregularities if the system itself proves to be defective.

Q7. WHAT IS INTERNAL CONTROL? WHAT ARE THE OBJECTIVES, ADVANTAGES & LIMITATIONS OF INTERNAL CONTROL?

Meaning and Definition

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.

According to The American Institute of Certified Public Accountants, “Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies.”

The system of internal control can be defined as, “the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business."

In brief it can be stated that internal control includes not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, to safeguard its assets and to secure as far as possible the accuracy and reliability of records.

Objectives/Need of the Internal Control:

1. Providing reliable data: Business decisions require accurate information o run the business efficiently. Examples of significant areas where management requires reliable information are fixation of selling prices production directives depending upon requirements etc. with the efficient internal control in place the accurate, required and reliable information can be provided for taking the important decisions and efficient performance of the activities.

2. To promote operational Efficiency: the controls within an organization are meant to prevent unnecessary duplication of efforts, protect against waste in all aspects of business and discourage other types of inefficient use of resources so as to promote the operational efficiency.

3. To encourage adherence to the prescribed policies: the system of internal control is meant to provide reasonable assurance that procedures and rules of various institutes are followed by company personnel.

4. Safeguarding assets and records: the physical assets of the company can be stolen, misused or accidently destroyed if not properly protected by adequate controls. The internal control helps to safeguard the physical assets and to secure the accuracy and reliabilities of the records of the company

Advantages of Internal Control

Application of internal control provides the following benefits to the various parties:

1. Internal control helps to protect the assets of the business from misuse, theft, accident etc.

2. Internal control helps to implement management policies to attain corporate goals.

3. Internal control helps the auditor in his/her work detecting all the errors and frauds which are committed in the books of accounts.

4. Internal control helps to increase the accuracy and reliability of financial statement and books of accounts.

5. Internal control helps to regulate the work of staffs through division of work among the staffs in a scientific manner which helps to make the daily works of staffs effective.

6. Internal control helps the management to prepare and implement effective plans by providing correct and fact information.

7. Internal control helps to put moral pressure on staffs.

Limitations of internal controls

A system of controls does not provide absolute assurance that the control objectives of an organization will be met. Instead, there are several inherent limitations in any system that reduce the level of assurance. These inherent limitations are as follows:

Collusion. Two or more people who are intended by a system of control to keep watch over each other could instead collude to circumvent the system.

Human error. A person involved in a control system could simply make a mistake, perhaps forgetting to use a control step. Or, the person does not understand how a control system is to be used, or does not understand the instructions associated with the system.

Management override. Someone on the management team who has the authority to do so could override any aspect of a control system for his personal advantage.

Missing segregation of duties. A control system might have been designed with an insufficient segregation of duties, so that one person can interfere with its proper operation.

Consequently, it must be accepted that no system of internal controls is perfect. There is always a way in which it can fail or be circumvented.

Q8. DIFFERENCE BETWEEN INTERNAL CHECKAND INTERNAL CONTROL AND INTERNAL AUDIT.

Internal Check, Internal Control and Internal Audit | Auditing

The upcoming discussion will update you about the differences among internal check, internal control and internal audit.

Difference # Internal Check:

1. Purpose:

Safeguarding or minimis-ing errors and frauds in actions transactions and records, and profacting assets. So as to ensure the efficient running of busi-ness.

2. Scope:

Rather restricted to formu-lation and working of proper accounting and other operational systems and reporting or offering suggestions to appropriate internal authorities.

3. Periodicity:

Proceeds simultaneously with initiation of transac-tions and ends with re-cording thereof.

4. Personnel:

Internal staff with no spe-cialised knowledge or skill but with clearly defined division of each work so that no one employee can be in complete control over completion and recording of any transaction—respon-sible to departmental/branch/unit-heads.

Difference # Internal Control:

1. Purpose:

Formulation and circu-lation of management principles and policies and effective and speedy execution there-of with the help of internal checking and internal audit activities.

2. Scope:

Wider in scope than internal check and in-ternal audit as specified above.

3. Periodicity:

Spreads through the process of internal checks upto taking ac-tion on internal audit reports.

4. Personnel:

Top management per-sonnel accountable to owners/stakeholders.

Difference # Internal Audit:

1. Purpose:

Detecting and report-ing errors and frauds and irregularities re-garding assets com-mitted, if any detec-tion and prevention activity-

2. Scope:

Limited to a continu-ous internal system of checking financial and non-financial opera-tions and reporting to internal top manage-ment.

3. Periodicity:

Commences after transactions are com-pleted and recorded.

4. Personnel:

Specially qualified and skilled audit staff as a part of internal person-nel responsible to sen-ior or top management

Q9.BRING OUT THE DIFFERENCE BETWEEN ACCOUNTANCY AND AUDITING

Basis	Accountancy	Auditing
1. Meaning	It is the process of recording, classifying, summarising and interpreting all the financial transactions.	It is the process of examining books of accounts and reporting on the financial statements.
2. Objectives	Its main objective is to find out profit earned or loss suffered by a company and to show the financial position of the company for a particular period.	Its main objective is to examine the correctness of the accounts and financial statements and certify that whether the company exhibits a true and fair view of state of affairs of the concern.
3. Nature of Employment	An accountant is a permanent employee of the organisation.	An auditor is an independent person and is not an employee of the organisation.
4. Qualification	An accountant does not require any formal qualification.	An auditor should be a qualified chartered accountant certified by the Institute of Chartered Accountants of India.
5. Reports	Accountant is not required to submit the report on the financial statements prepared by him.	Auditor should submit the report certifying the truth and fairness of the financial statements.
6. Remuneration	An accountant is remunerated in the form of salary.	An auditor is remunerated in the form of professional fees.
7. Commencement of work	Accountancy starts where Book-keeping ends.	Auditing starts where Accountancy ends.

Q9. WHAT ARE THE MAIN OBJECTIVES OF VOUCHING THE CASH BOOK AND HOW DO YOU DO IT

Meaning and Definition

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts. Some important definitions of vouching are:

"Vouching means testing the truth of items appearing in the books of original entry." – J.R. Batliboi

"Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof." - Dicksee

From the above definitions we can conclude that vouching is a technique in which an auditor verifies authenticity and authority of transactions recorded in the books and on the basis of which he submits a report, indicating that accounts are correct, free from errors or fraud and complete.

Objectives of Vouching:

1. All the transactions which are connected with the business have been recorded in the books of accounts properly.
2. To verify that all transactions recorded in the books of accounts are supported by documentary evidence.
3. The vouchers which support the entries are legally valid from the view point that they are authentic, addressed to the business and properly dated.
4. To verify that no fraud or error has been committed while recording the transaction in books of accounts.
5. The vouchers have been processed carefully through various stages of internal check system.
6. While recording the transaction whether distinction has been made between capital and revenue items.
7. Whether accuracy has been observed while totaling, carrying forward and recording an amount in the account.

Vouching of cash Transactions:

How to vouch various cash receipts (Receipt side)

1. Cash sales: In vouching cash sales, cash register should be fully checked with carbon copies of cash memos. Then, the auditor should verify the daily deposits of cash received in the bank dates of the cash and the date on which the receipts are recorded in cash book must be same. Where the cash memos are cancelled, all copies including the original copy duly cancelled should be kept in the book. Where a company has a discount policy, if more discount is allowed in a transaction it must be approved by a responsible officer.
2. Cash received from the debtors: The auditor should verify amount received from debtors from the counterfoils or carbon copies of the receipt issued to the customers. All these

receipts should be serially numbered. Amount should be entered in the cash book on the day when received. Discount allowed to customers should be authorized by a responsible officer. Sometimes correspondence made with customer can also be verified.

3. Loans: While vouching the loans received, the terms and the conditions contained in the agreement should be verified. If the loan is secured what security has been offered, whether the fact has been disclosed in the balance sheet.

4. Bills receivable: Bills receivable book maybe verified because the various details regarding the bills matured and discounted are available in it. Auditor should check the amount received with the bank statement. Some bills might have become due but no amount has been received. Whether the entry for the dishonor of such bill has been made.

A verification of the bills discounted should be made. Whether, entry for discount has been made. Such bills should appear as contingent liability in the balance sheet; if the date of maturity is after the date of balance sheet.

5. Sale of Investment: If the sales have been affected through a bank, the auditor should examine the bank advice to know the various details. Sometimes the investment is sold through the broker. Broker's sold note or commission should be examined to verify the sale proceeds and commission charged by the broker.

If the investments are sold at cum-dividend price, auditor should see that proper apportionment has been made between capital receipts and revenue receipts.

Sometimes the investments are made against specified funds. Profit or loss on sale of such investments must be transferred to such funds account.

6. Sale of Fixed Assets: Sale of fixed assets may be vouched with minute book of board of directors, correspondence, agents' sale account and sale contract. It should be seen that proper account has been credited. Any profit arising on the sale of asset shall be credited to revenue account which is not available for distribution of dividends. If any expense on the sale of assets is paid, the sale proceeds of the asset should be reduced by such amount and the balance should be credited to asset account. It must be seen that sale of fixed assets has been sanctioned by the authorized person or committee.

Vouching of cash payments (payment side):

1. Cash Purchases: good purchased are actually received by store keeper. Cash memos can be compared with goods inward book to verify the goods received. Only the net amount (after trade discount) should be entered in the books.

2. Payment to creditors: Should be examined with the receipts issued by the creditors. The receipts should indicate the purpose for which the payment has been made. If the payment is made in full and final settlement of account, the balance should be accounted for as discount received. Where the payment is made in excess of the bill, either the excess payment is in advance or the payment is made by mistake, which should be recovered back from the creditor.

3. Bills payable: Bills payable honored on the date of maturity and is returned by the payee after receiving the payment. These bills should be cancelled after being paid. Bills payable paid can be vouched with bills book. If the payment is made by the bank, bank statement or pass book can be examined to verify the payment of bill

4. Wages: wages paid and calculated for various months should be compared. If the wages of particular month differ from the preceding month, the auditor should look into the reasons for difference. Random checking of wages calculations should be made. The auditor should see the proper record is maintained for unpaid wages, deductions for any advance taken by the worker should also be verified, and deductions made from the wages should also be entered in the proper account. Special attention should be given to the payments made to

5. Payment of Salaries: in vouching the payment of salaries following points are important

a. Auditor should check salary register with the entries made in the cash book

b. He should examine carefully alterations in the amount of deductions on account of fines, funds, loans, insurance etc.

6. Purchase of Investment: the auditor should compare the investment purchased with Broker's Bought Note. If the possible, physical verification of investments should be made. Investments must be in the name of the company. Where the investments are purchased at cum-interested price, interest included in the purchase price should be debited in the interest account and the balance in investment account. Later on when the interest is received on the investment, it should be credited in the interest account.

7. Rent paid: the auditor should verify the payment of rent from the agreement. The ret voucher should be supported by rent receipt from the landlord. It should be seen that payment of rent is sanctioned by responsible officer.

8. Loans: Auditor should be that the loan voucher should be supported by the receipt given by the party. Further details regarding terms and condition of the loan can be verified from the loan agreement. It should be seen that installment of loan along with interest are received in time. Mortgage Deeds and other documents should also be examined.

9. Interest on Loan: Auditor should verify that rate of interest on loan does not differ from the terms and conditions of loan agreement. Debenture interest can be verified from debenture interest book. All the payments of interest must be supported by vouchers and receipts.

Q10.DUTIES AND RIGHTS OF AN AUDITOR explain..

Rights of an Auditor

1. Right to Access books of accounts: Every auditor of a company has right to free and complete access at all the times to the books, accounts and vouchers of the company

2. Right to obtain the information and explanation: An auditor is authorized to obtain such information and explanation as the auditor may think necessary for the performance of his duty as auditor.

3. Right to receive notice: All notices of the company and other communications relating to any general meeting of the company shall be forwarded to the auditor of the company. He is also authorized to attend the meetings and make any statement or explanation with regard to the accounts audited by him.

4. Right to sign audit report: only the person appointed as auditor of the company, where a firm so appointed only a partner in the firm practicing in India, may sign the auditor's report or authenticate any other document of the company required law to be signed or authenticated by auditor.

5. Right to seek legal and technical advice: The auditor of a company is entitled to seek the legal and technical advice which may be needed in the performance of his duties.

6. Right to remuneration: on completion of his work an auditor is entitled to his remuneration.

7. Right to be indemnified: for many purposes, an auditor is considered to be an officer the company. An officer has a right to be indemnified out of the assets of the company against any liability.

Duties of an Auditor: Duties under section 143 (1):

a. The auditor has a duty to enquire whether loans and advances made by the company have been properly secured whether the term and the conditions there of are prejudicial to the interest of the company or its members.

b. Duty to enquire whether assets of the company being shares or debentures and other securities have been sold at a price less than at which these were purchased.

c. Whether any shares have been allotted for cash, whether cash actually received and whether the position in the account books and balance sheet is correct, regular and not misleading.

Duties under section 143 (2):

The auditor has the duty to report the members of the company, the accounts examined by him and every financial statement to be laid before the company in the general meeting. The auditor shall state in his report to the best of his information and knowledge, the said accounts and financial statements whether give a true and fair view or not, of the state of company's affairs

Duties under section 143(3):

1. He has the duty to sought and obtain all information and explanation which are necessary for his audit.

2. He has a duty to ensure that the books of accounts as required by law have been kept by the company.

3. He has a duty to see whether the company has adequate internal financial control systems in place and their operative effectiveness.

4. He has a duty to ensure whether the company's balance sheet and profit and loss account dealt within the report or in agreement with the books of account and returns.

Q11. WHAT IS VERIFICATION OF ASSETS? DISTINGUISH BETWEEN

Verification

Meaning and Definition

Verification means the procedures normally carried out at the year end, to confirm the ownership, valuation and existence of items at the balance sheet date. In simple words verification means, 'proving the truth or conformation.'

"The verification of assets implies an enquiry into the value, ownership and title, existence and possession, and the presence of any charge on the assets." - Spicer and Pegler

Valuation

Meaning and Definition

Valuation means to set the exact value of an asset on the basis of its utility. Valuation forms an important part of the everyday audit. It is because the accuracy of balance sheet depends much upon how correctly the estimation of the value of various assets and liabilities has been made. Both over- 27

valuation and under- valuation of assets and liabilities would exhibit wrong picture of the financial affairs of a concern. The auditor has to see that the assets and liabilities appearing in balance sheet have been exhibiting their proper value i.e. neither they have been over-valued nor under-valued.

Difference between Verification and Valuation

Sr. No.	Basis	Verification	Valuation
1	Meaning	Verification Verification means clarifying the existence, valuation, existing obligations and accuracy of the items stated in the Balance Sheet.	Valuation Valuation involves a critical examination of the pre-determined values of the assets by the auditor on the basis of accounting principles and conventions.
2	Advice	The assets are verified by the auditor himself.	The auditor can obtain the help of an expert for the valuation of assets.
3	By Whom	Verification is done by the auditor himself or his senior partner.	Valuation is done by the management of an organisation but the accuracy of this valuation is done by the auditor.

4	Guarantee Or Responsibility	The auditor is responsible for the verification of assets.	The auditor cannot give a guarantee for the valuation of assets as determined by the expert.
5	Evidence	Adequate physical and documentary evidence is available for verification.	Very little actual proof is available for valuation therefore the auditor has to rely to a very large extent on the estimates of the management.

Q12.DIFFERENCE BETWEEN AUDITING AND INVESTIGATION

Sr. No.	**Basis**	**Auditing**	**Investigation**
1	Object	The object of auditing is to establish the completeness, correctness and truthfulness of the accounts of an organization	The aim of investigation is detection of frauds or defalcations, or in-depth examination for some specific purpose.
2	Terms	Auditing involves the examination of books of accounts of the business for a year.	Investigation involves the examination of books of accounts for a number of years.
3	On Whose Behalf	Audit is usually conducted on behalf of the owner of the business.	Investigation is usually on behalf of external persons, though sometimes it may be ordered by the owner also.
4	Necessity	Many institutions such as, insurance companies, banking companies public and private companies are required by law to get their accounts audited.	Investigation is not legally compulsory in any circumstances. It is totally optional whether or not to get an investigation conducted.
5	Scope	The scope of auditing is limited as it only involves examination of books of	Investigation is wider in scope as, apart from books of accounts,

		accounts.	other acts can also be examined.
6	Qualification	An auditor has to be a chartered accountant.	A qualified and experienced accountant may also be an investigator.
7	Frequency	An audit is usually conducted on a yearly basis.	Investigation is conducted only in certain specific situations.
8	Type Of Checking	Test checking may be used in an audit.	In an investigation the checking has to be complete and in-depth.
9	Report	In an audit the report has to be as per the specifications of the relevant Act.	In an investigation the report depends upon the nature of the investigation.
10	Criticism	In the report only those points are mentioned with which the auditor does not agree. In other words, auditing is not critical.	In an investigation the work is conducted with the aim of achieving a specific result and it is done from a critical point of view.
11	Documents	In auditing work is done on the basis of documents, vouchers and correspondence.	In an investigation, apart from vouchers, and documents, other facts are also examined.

Q13.DIFFERENCES BETWEEN INTERNAL AUDIT VS EXTERNAL AUDIT

Differences between Internal Audit and External Audit:

- **Legal Status:** Internal audit is discretionary or not compulsory; but external audit is obligatory or compulsory by law.
- **Nature of Audit:** Internal audit is carried out on continuous basis; while external audit is carried out after the preparation of final accounts and financial statements usually on yearly basis.

- **Objective:** Objective of internal audit is to evaluate and improve the effectiveness of accounting, financial activities, governance, risk management and other control processes of the company; while objective of external audit is to add credibility to the financial statements and reports of the company.
- **Coverage:** Internal audit covers financial statements and records, various risks, and other operational activities; while external audit covers financial statements and records.
- **Type of Checking:** Internal audit involves the checking of almost all the financial statements and records; while external audit may be carried out through test checking or sample checking.
- **Scope:** The scope of internal audit is determined by the management of the company; while the scope of external audit is determined by the relevant law or a regulator.
- **Focus:** The primary focus of internal audit is to find out errors and frauds; while the primary focus of external audit is to verify the accuracy and reliability of the financial statements, and to judge whether the financial statements provide a true picture of the actual financial position of the entity.
- **Report Submission:** Internal audit report is submitted to the management of the company or organization; while external audit report is submitted to the shareholders, or in some cases, to a regulator.
- **Guidance:** Internal audit involves making suggestions for the improvement of financial statements, accounting and related activities to the management of the organization or the company; whereas external audit usually does not involve making such suggestions, except in some cases with specific requirements.
- **Audit Activity:** Internal audit is usually carried out by an employee of the company; but external audit is carried out by an independent person or agency.
- **Appointment:** Internal auditor is appointed by the management of the company; while the external auditor is appointed by the shareholders of the company, or a regulator.
- **Qualification:** Any specific or prescribed qualification is not compulsory for internal auditor; but some specific or prescribed qualification is compulsory for an external auditor.
- **Remuneration Type:** Internal audit is carried out by a company employee who gets a salary usually on monthly basis; while a specific audit fee is paid for the external audit, usually based on the audit assignment.

- **Remuneration Fixation:** Internal auditor remuneration, i.e., salary is fixed by the management of the company; while fee for external audit is fixed by the shareholders of the company.
- **Shareholder Meetings:** Internal auditor does not attend the meetings of the shareholders of the company; whereas external auditor may attend the shareholder meetings.
- **Removal of Auditor:** Internal auditor can be removed by the company management; whereas external auditor can be removed by the shareholders of the company.
- **Professional Misconduct:** Internal auditor is not prosecuted for professional misconduct; while external auditor can be prosecuted for professional misconduct as per the procedure prescribed under the relevant law or statutes.

Q14. WHAT IS AN AUDIT NOTE BOOK? WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF AUDIT NOTE BOOK?

Audit Note book:

Audit note book is a diary or register maintained by audit staff to note errors, doubtful quarries and difficulties. The purpose is to note down the various points which need to be either 13

Clarified with the client or the chief editor. The Audit note book is used for recording important points to be included in the auditor's report.

Contents of an Auditor's Note Book:

1. A list of books of accounts maintained.

2. The names, duties and responsibilities of principal officers.

3. The particulars of missing receipts and vouchers.

4. Mistakes and errors detected.

5. The points which need clarifications and explanations.

6. The points deserving the attention of the auditor.

7. Various totals and balances.

8. The Points to be a part of auditor's report.

Advantages of Audit Note book:

Some of the advantages of the audit note book are.

1. It ensures the uniformity and helps in knowing the amount of work performed.

2. Important matters relating to the audit work may be easily recalled.

3. Facilities and preparation of the audit report.

4. In case of the assistant in charge is changed, no difficulty is faced in continuing the incomplete work.

5. The responsibility of the errors undetected can be fixed on clerk concerned.

6. The audit note book shows the extent of the interest and pain taken by the audit staff. It helps in their appraisal.

7. It ensures that the audit programme has been sincerely followed. Deviations can be noticed.

8. It is reliable evidence in the court of law, If an auditor has to defend himself.

DISADVANTAGES OF AUDIT NOTE BOOK

There are, however, certain disadvantages of audit note book. They are as follows:

1. Very often, it creates misunderstanding between the client staff and the audit staff.

2. If it is not properly and carefully prepared it cannot be used as evidence against the auditor for negligence.

3. It develops a fault finding attitude in the minds of the staff of the audit.

4. Audit staff has to depend too much upon the client's staff for its preparation.

SHORT ANSWER QUESTIONS

Auditing

The word Audit is derived from Latin word "Audire" which means 'to hear'. Auditing is the verification of financial position as disclosed by the financial statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business. Auditing is the intelligent and critical test of accuracy, adequacy and dependability of accounting data and accounting statements.

Importance of Auditing (or) Need of Auditing

a. Audited accounts help a sole trader in knowing the value of the business for the purpose of sale.

b. Dispute over correctness of profits can be avoided.

c. Shareholders, who do not know about day-to-day administration of the company , can judge the performance of management from audited accounts.

d. It helps management in detecting and preventing errors and frauds.

e. Management gets advice on financial affairs from the auditors.

Continuous Audit

The Continuous Audit is conducted throughout the year or at the regular short intervals of time.

"A continuous audit involves a detailed examination of all the transactions by the auditor attending at regular intervals say weekly, fortnightly or monthly, during the whole period of trading." - T.R. Batliboi

"A continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or hiss staff attends at regular or irregular intervals during the period." -R.C Williams

Qualities of an Auditor

1. Only the qualified chartered accountant can be appointed as auditor of a limited company.
2. The auditor must have thorough knowledge of principles and practice of all aspects of accountancy. He must be familiar with all systems of accountancy in use.
3. He should have adequate knowledge of financial management, industrial administration and business organization.
4. He must have thorough knowledge of audit case laws as per the various cases decide by the courts in and outside India.

Appointment of an Auditor

The appointment of Auditor in case of sole trader is done by the owner of the business. In case of sole traders the auditor generally acts as an accountant who also prepares accounts besides checking their accuracy. As He is appointed by an individual he must get clear instructions from his client in writing as to what he is expected to do. His work and its scope will depend upon the agreement with his client since the appointment of an auditor is not under any statute, therefore the rights and the duties will depend upon the agreement.

Removal, Resignation of an Auditor

1. The Auditor appointed under section 139 may be removed from his office before expiry of is term only by a special resolution of the company after obtaining the previous approval of the central Government.
2. The Auditor who resigns from the company shall file within a period of thirty from the date of resignation, a statement in a prescribed form with the company a registrar, the auditor shall also file such statement with the comptroller and auditor –general indicating the reasons and other facts as may be relevant with regard to his resignation.

Audit Program

Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of work of examination and a set of audit procedures.
According to Megis, An audit programme is a detailed plan of the auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.
According to holmes, Audit programme is a flexible planned procedure of examination. Thus audit programme is a planning of audit by auditor so that he may be able to complete his work in a diligent manner and complete the work without loss of time.

Internal Control

Internal control is a broad term with a wide coverage. It covers the control of whole management system. Internal control involves a number of checks and controls exercised in a business to ensure its efficient and economic working.
The system of internal control can be defined as, "the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving the management's objectives of ensuring, as far as practicable, the orderly and efficient conduct of its business."

Internal Check

Internal check is the valuable part of the internal control. It is an arrangement of the duties of members of staff in such a manner that the work performed one person is automatically and independently checked by the other.

According To Joseph Lancaster, "The internal check is a method of organizing the entire operations, office, warehouse, factory and the duties to the respective staff so that frauds and irregularities are impossible without collusion."

All the definitions of internal check give a common idea about system organized within the concern itself, wherein the work of one employee is automatically checked up by the other and the possibility of error or fraud is reduced to the minimum.

Audit Note book

Audit note book is a diary or register maintained by audit staff to note errors, doubtful quarries and difficulties. The purpose is to note down the various points which need to be either

Clarified with the client or the chief editor. The Audit note book is used for recording important points to be included in the auditor's report.

Vouching

Vouching is concerned with examining documentary evidence to ascertain the authenticity of entries in the books of accounts. In other words it is an inspection by the auditor of evidence supporting the transactions made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts

"Vouching means testing the truth of items appearing in the books of original entry." – J.R. Batliboi

"Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof." – Dicksee

Types of Vouchers

1. Debit or Payment voucher
2. Credit or Receipt voucher
3. Non-cash or Transfer Voucher
4. Supporting Voucher.

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