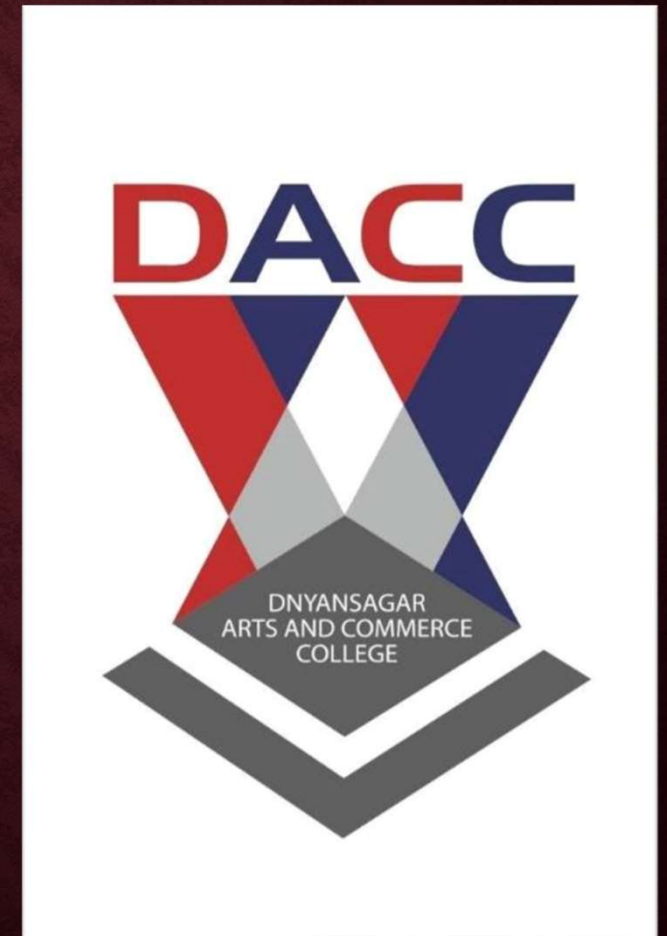


DNYANSAGAR ARTS AND COMMERCE COLLEGE

SUBJECT:AUDITING

SUBJECT CODE: 304

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SECTION I





UNIT 1 –INTRODUCTION PRINCIPLES OF AUDITING AND AUDIT PROCESS

KEY POINTS

- ❖ **Auditing: Meaning, Objectives, Principles, Scope.**
- ❖ **Errors and Frauds in Auditing: Types of error, Location of error, Types of Fraud, Difference between Fraud and error.**
- ❖ **Advantages of Auditing.**
- ❖ **Limitation of Auditing.**
- ❖ **Types of Audit.**
- ❖ **Audit Process.**
- ❖ **Internal control, Internal check and Internal Audit.**



MEANING

Auditing is a systematic examination of the books of records of business.

Meaning of Audit is a thorough inspection of the books of accounts of the organization. The person who carries out an audit is the auditor

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 organization

OBJECTIVES OF AUDITING

PRIMARY OBJECTIVE

1. To Examine the Accuracy of Books of Accounts
2. To Express Opinion on Financial Statements

SECONDARY OBJECTIVE

1. Detection and Prevention of Errors
2. Detection and Prevention of Frauds



PRINCIPLES

- ❖ Principles of competency.
- ❖ Principles of Independence
- ❖ Principles of Integrity.
- ❖ Principles of Confidentiality.
- ❖ Principles of Objectivity.
- ❖ Principles of Documentation.
- ❖ Principles of Planning.
- ❖ Principles of Audit Evidence.
- ❖ Principles of Accounting system and Internal control.
- ❖ Audit conclusions and Report.



SCOPE

The amount of time and documents which are involved in an audit, is an important factor in all auditing. The audit scope, ultimately, establishes how deeply an audit is performed. It can range from simple to complete, including all company documents



ERRORS AND FRAUDS IN AUDITING

TYPES OF ERRORS

Clerical Errors

Errors of Principle

Compensating Errors

Errors of Duplication

ERROR OF COMMISSION

ERROR OF OMISSION

PARTIAL OMISSION

COMPLETE OMISSION



TYPES OF FRAUD

TYPES OF fraud

Employee Fraud

Embezzlement of cash

Misappropriation of goods

Management Fraud

Manipulation of accounts.

Omission of events.

Misapplication of accounting policies.

Internal control system overridden



ADVANTAGES OF AUDITING

- ❖ Audit Helps to Detect and Prevent Errors and Frauds.
- ❖ Audit Helps to Maintain Account Regularly.
- ❖ Audit Helps to Get Compensation.
- ❖ Audit Helps to Obtain Loan.
- ❖ Audit Facilitates the Sale of Business.
- ❖ Audit Helps to Assess Tax.
- ❖ Audit Facilitates to Compare.
- ❖ Audit Helps to Adjust Account of Deceased Partner.



LIMITATION OF AUDITING

- ❖ **Rely on Experts**
- ❖ **Efficiency of Management**
- ❖ **Checking of All Transactions**
- ❖ **Additional Financial burden**
- ❖ **Not Easy to Detect Some Frauds**



TYPES OF AUDIT

Ownership	Periodicity	Objectives	Scope of Audit	Employer of Auditor	Manner of Checking
Private Audit	Continuous	Financial	Complete	Internal	Standard
Government Audit	Annual	Operational	Partial	External	Balance Sheet
Statutory Audit	Interim	Cash Audit			Post & Vouch Audit
	Occasional	Management			
	Concurrent	Tax			
		Social			
		Environment			



AUDIT PROCESS

The Audit process is a well-defined methodology for organizing an audit and is adopted to accomplish audit objectives.

An audit process may consist of the following steps:

Define Audit Objectives

Audit Announcement

Planning

Fieldwork

Reporting



AUDIT PROGRAM

1. Audit program is nothing but a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed.
2. An audit program consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements.
3. 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.



WORKING PAPER

- 1.The audit working papers constitute the link between the auditor's report and the client's records.
- 2.The objects of an auditor's working papers are to record and demonstrate the audit work from one year to another
3. Working papers are varied in nature. They may be recorded on paper or on electronic or other media. Examples include:
 - Audit programmes.
 - Analyses.
 - Issues memoranda.
 - Summaries of significant matters.
 - Letters of confirmation and representation.
 - Checklists.



INTERNAL CONTROL

Internal controls are the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud. Besides complying with laws and regulations and preventing employees from stealing assets or committing fraud, internal controls can help improve operational efficiency by improving the accuracy and timeliness of financial reporting.



INTERNAL CHECK

Internal Check is an integral function of the internal control system. It is an arrangement of duties of the staff members in such a way that the work performed by one person is automatically and independently checked by the other.



INTERNAL AUDIT

Internal Audit is a department or an organization of people within a company that is tasked with providing unbiased, independent reviews of systems, business organizations, and processes.



UNIT 2 – CHECKING , VOUCHING AND AUDIT REPORT

KEY POINTS

- ❖ **Test Checking**
- ❖ **Voucher**
- ❖ **Vouching**
- ❖ **Vouching of cash book.**
- ❖ **Audit report**
- ❖ **Audit certificate**
- ❖ **Auditing and Assurance standard**



TEST CHECKING

It is the examination of few transaction of business, instead of checking all transaction.



VOUCHER

It is a documentary evidence supporting a business transaction. It may include:

- ❖ A receipt.
- ❖ An invoice.
- ❖ Bank Paying slip.
- ❖ Debit note.
- ❖ Credit note.
- ❖ Gatekeeper's books of entry.
 - ❖ Wage book.
 - ❖ Order book.



TYPES OF VOUCHER

PRIMARY



CASH MEMO

RENT RECEIPT

SECONDARY



CARBON COPY OF CASH MEMO

COUNTER FOIL OF PAY -IN -SLIP



VOUCHING

Vouching can be described as the essence or backbone of auditing. Vouching is defined as the "verification of entries in the books of account by examination of documentary evidence or vouchers, such as invoices, debit and credit notes, statements, receipts, etc.



VOUCHING OF CASH BOOK

In a business concern, cash book is maintained to account for receipts and payments of cash. It is an important financial book for a business concern. Hence the auditor should see whether all receipts have been recorded in cash book and no fictitious payment appears on the payment side of cash book. To ensure this an auditor should check debit side of cash book which represents as receipts and credit side which contains payment details.



VOUCHING AND VERIFICATION

Both are considered to be same thing but there are lots of difference between vouching and verification.

Vouching relates to confirmation of the correctness and authenticity of accounting entries as appeared in the books of accounts whereas verification confirms the existence, ownership and valuation of assets as appears in the balance sheet. The Auditor's duty is not only vouching the entries appearing in the books because vouching cannot prove the existence of the related asset or liabilities at the balance sheet date



OBJECTIVES OF VERIFICATION

Following are the objectives of Verification –

Confirmation about the existence of assets through physical verification.

Legal and official documents relating to assets are checked to confirm the ownership of assets.

It is confirmed that assets are free from any charge of lien.

Proof regarding proper valuation of assets.

To confirm that assets are properly accounted for in the books of accounts .



AUDIT REPORT

An audit report should be clear, specific and complete, in order that anyone who has an occasion to read it may know exactly what is wrong with the company. The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involve considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements.



TYPES OF AUDIT REPORT

UNQUALIFIED REPORT

QUALIFIED REPORT

DISCLAIMER REPORT

ADVERSE REPORT



UNQUALIFIED REPORT

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in REPORT presentation of the financial statements.



QUALIFIED REPORT

The auditor shall express a qualified opinion when:

The auditor, having obtained sufficient appropriate audit evidence, concludes that **misstatements**, individually or in the aggregate, **are material**, but not pervasive, to the financial statements

The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.



DISCLAIMER REPORT

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion

the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Thus, disclaimer report is issued when there is insufficient evidence to form an opinion.



ADVERSE REPORT

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that financial statement do not give a true and fair view, and the matter of disagreement with management is material and pervasive.



AUDIT CERTIFICATE

An Auditor's certificate is a written confirmation of the accuracy of the facts relating to the accounts for a particular time or to a specific matter.



AUDITING AND ASSURANCE STANDARD 1 (SA200)

- ❖ Integrity, objectivity and independence
- ❖ Confidentiality
- ❖ Skill and Competence
- ❖ Work Performed by Others
- ❖ Documentation
- ❖ Planning
- ❖ Audit Evidence
- ❖ Accounting System and Internal Control
- ❖ Audit Conclusions and Reporting



AUDIT EVIDENCE UNDER AAS – 5 (SA500)

- ❖ **Inspection**
- ❖ **Observation**
- ❖ **Inquiries and Confirmation**
- ❖ **Computation.**
- ❖ **Analytical Reviews**



UNIT3 – COMPANY AUDITOR

KEY POINTS

- ❖ **Auditors Qualification.**
- ❖ **Disqualification.**
- ❖ **Appointment of auditor**
- ❖ **Removal of an auditor.**
- ❖ **Rights and duties of a company auditor**
- ❖ **Liabilities of a company auditor**



AUDITORS QUALIFICATION

Qualification of a Company Auditor

According to Section 226(1) and 226(2) of the Companies Act, the prescribed qualifications of an auditor are as follows:

Qualification [sec226 (1)]

1. The auditor of a co. may be either, an individual or a firm
2. In the case of an individual, he should be a Chartered Accountant within the meaning of Chartered Accountants Act 1949 i.e. he should be holding certificate of practice.
3. In the case of firm of auditor's all the partners of a firm shall be chartered accountants practicing in India within chartered accountants Act1949.

Qualification [Sec 226(2)]

A person holding a certificate issued by central govt. under restricted state auditors rules prior to the enactment of part B state laws 1951 can also be auditor of the co.

The central government is empowered to frame rules relating to granting renewals, suspension or cancellation of such certificates.



DISQUALIFICATION OF A COMPANY AUDITOR

According to section 226(3) of the Companies Act, the following persons shall not be appointed as auditors of a company:

1. A body corporate. A company cannot audit any other company,
2. An officer or employee of the company.
3. A person who is either a partner or employee of an officer or employee of the company.
4. A person who has taken debt from the company for amount exceeding Rs. 1,000.
5. A person who has taken guarantee of another person who has taken a loan exceeding Rs. 1,000 from the company.
6. A person who holds shares or debentures of the company cannot audit that company.



REMOVAL OF AN AUDITOR

Removal of first auditor: The company can remove the first auditor appointed by the directors, in a general meeting. The central government's approval is not needed for the removal of first auditor's .

Removal of subsequent auditor: Any subsequent auditor can be removed from the office before the expiry of his term only by the company in its general meeting , after obtaining the prior approval of the central government and following the same procedure as laid down for appointment of an auditor in the place of a retiring auditor.



RIGHTS OF A COMPANY AUDITOR

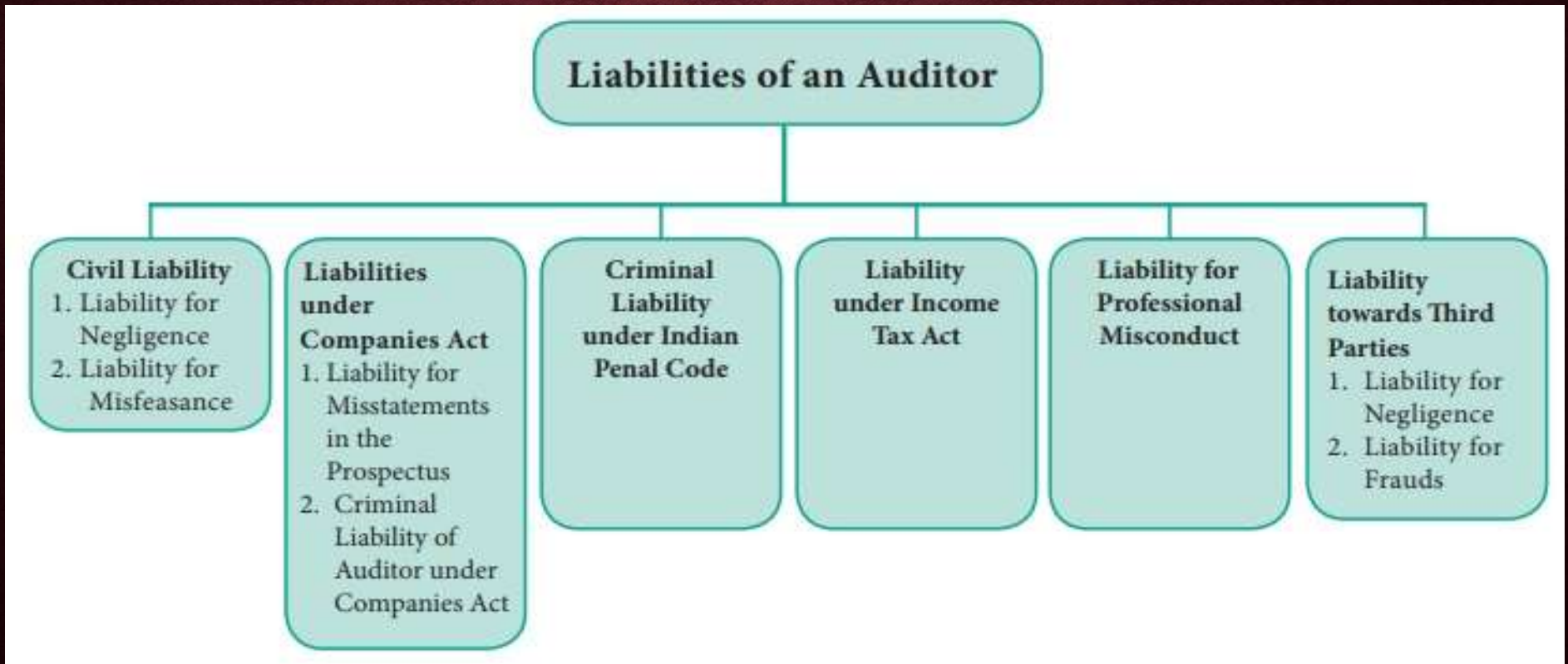
- ❖ **Rights to access the books and records**
- ❖ **Right to get explanations from company staff**
- ❖ **Right to receive notice of general meetings**
- ❖ **Right to visit branches**
- ❖ **Right to seek legal and technical advises**
- ❖ **Right to claim remuneration**
- ❖ **Right to refuse to commence the audit**
- ❖ **Right to question the board**
- ❖ **Right to qualify his report**
- ❖ **Right of indemnity**



DUTIES OF A COMPANY AUDITOR

1. Report shareholders about true and fair state of affairs of the company
2. State that balance sheet and profit and loss a/c give all information required by law
3. State that balance sheet and profit and loss a/c agree with the books of account
4. State that balance sheet and profit and loss a/c agree with accounting standards
5. State that he has obtained all the necessary information
6. State whether the company has maintained all books as required by law;
7. State the reasons of qualification in his report
8. State that he has received the audit report on the branch accounts audited by other auditor and how he has dealt with the same in preparing his report

LIABILITIES OF A COMPANY AUDITOR





UNIT4 –TAX AUDIT

KEY POINTS

- ❖ **Meaning.**
- ❖ **Scope of auditor's role under the income tax act.**
- ❖ **Certificate of claiming exemptions.**
- ❖ **Selective tax audit.**



MEANING

A tax audit is a formal examination conducted by the IRS to verify information or uncover fraud and inaccurate tax returns. The IRS selects tax returns to examine both randomly and intentionally. If the audit is selected randomly, the IRS will simply take a closer look to make sure all information are accurate. The IRS will intentionally audit certain tax returns if there are issues, errors, or possible frauds in reporting the tax return. Tax audits can be broken down into four different types

Correspondence Audit: This is the least serious type of tax audit. A correspondence audit refers to the IRS request of additional information to verify the accuracy or details of your tax return.

Office Audit: An office audit refers to the in-person interview with an IRS manager to process your audit. To avoid making statements that can be used against you, it's highly advisable to consult with an attorney or a tax professional before you attend the interview.

Field Audit: This is the most serious type of audit because the IRS agents will visit you at home or business. They may ask to see things that are related to the tax you've reported.

Random Audit: As mentioned above, tax returns can be randomly selected for an audit. A random audit is made without any particular reason. The IRS auditor will review the entire tax return to make sure the information was entered correctly.



SCOPE OF AUDITOR'S ROLE UNDER THE INCOME TAX ACT.

Category of person	Threshold Business
Carrying on business (not opting for presumptive taxation scheme*)	Total sales, turnover or gross receipts exceed Rs 1 crore in the FY
Carrying on business eligible for presumptive taxation under Section 44AE, 44BB or 44BBB	Claims profits or gains lower than the prescribed limit under presumptive taxation scheme
Carrying on business eligible for presumptive taxation under Section 44AD	Declares taxable income below the limits prescribed under the presumptive tax scheme and has income exceeding the basic threshold limit
Carrying on the business and is not eligible to claim presumptive taxation under Section 44AD due to opting out for presumptive taxation in any one financial year of the <u>lock-in period i.e. 5 consecutive years from when the presumptive tax scheme was opted</u>	If income exceeds the maximum amount not chargeable to tax in the subsequent 5 consecutive tax years from the financial year when the presumptive taxation was not opted for
Carrying on business which is declaring profits as per presumptive taxation scheme under Section 44AD	If the total sales, turnover or gross receipts does not exceed Rs 2 crore in the financial year, then tax audit will not apply to such businesses.



Profession

Carrying on profession

Total gross receipts exceed Rs 50 lakh in the FY

Carrying on the profession eligible for presumptive taxation under Section 44ADA

1. Claims profits or gains lower than the prescribed limit under the presumptive taxation scheme

2. Income exceeds the maximum amount not chargeable to income tax



CERTIFICATE OF CLAIMING EXEMPTIONS

CA certificate in case of exemption or deduction claim by the assessee. CBDT Should make it mandatory to obtain the CA certificate in case of exemption or deduction claim by the assesseees is in excess of certain amount for other than audit and salaried assesseees for verifying the correctness and genuineness of claim.



UNIT5 –AUDIT OF COMPUTERIZED SYSTEM

KEY POINTS

- ❖ **Meaning.**
- ❖ **Types of EDP accounting system.**
- ❖ **Problems of EDP environment.**
- ❖ **Controls in an EDP environment.**
- ❖ **Audit approach in an EDP environment**
- ❖ **Computer Assisted Audit techniques**



MEANING

It is the audit of all information system assets, to ensure that they are adequately safeguarded against vulnerabilities of natural and manmade disasters. The type is identified with reference to the risk exposure. It is performed by qualified information system auditors. The detection of frauds and errors are by ensuring various safeguards prescribed by the systems men, internal and external auditors qualified to perform systems audit.



TYPES OF EDP ACCOUNTING SYSTEM

Some of the most popular methods of electronic data processing are explained below:

- ❖ Time-sharing
- ❖ Real-time processing
- ❖ Online processing
- ❖ Multiprocessing
- ❖ Multitasking
- ❖ Interactive processing
- ❖ Batch processing
- ❖ Distributed processing



PROBLEMS OF EDP ENVIRONMENT.

- 1.Theft of Computer Time:** Information created by one person may be easily copied by another person who can claim that the data is his own and he is the actual creator. In computers there is nothing like original copy and duplicate copy.
- 2. Manipulation of Programs:** An intruder, rival or competitor can manipulate, modify or delete one or more programs of a company making the complete software unusable
- 3.Theft of Data:** Data stored in a computer can be copied into floppies and could be delivered to competitors. With modern communication networks available, insiders of the company may send confidential information of a company to another. Hackers can connect to network and steal data.
- 4. Stealing Software:** An intruder, rival or competitor can manipulate, modify or delete one or more programs of a company making the complete software unusable.
- 5. Controlling Access:** Controlling of hardware and software should be the first system security. The system should be under lock and key to prevent hardware theft. Physical and electronic access control techniques including keyboard locks, automatic logs, restricted access to systems and limited after-hour use.
- 6. Passwords:** Passwords should be provided at all levels of system. They should be changed frequently or as and when needed so that unauthorized users cannot enter into the system.



CONTROLS IN AN EDP ENVIRONMENT

Internal Control in an Electronic Data Processing system

Internal controls in computer-based accounting system are of two basic types:

- 1) General controls or organization controls**
- 2) Application or procedural controls**



GENERAL CONTROLS OR ORGANIZATION CONTROLS

SYSTEMS DEVELOPMENT AND CONTROL

ADMINISTRATIVE CONTROLS



SYSTEMS DEVELOPMENT AND CONTROL

- ❖ **Standards:** There should be standard procedures to be followed anytime an application is introduced. This will include adequate feasibility studies, covering investigation, fact recording and analysis of gathered facts.
- ❖ **Documentation:** There should be proper documentation using flow charts, decision tables, structured English etc and all these should be incorporated in a manual for use.
- ❖ **Testing:** The new system should be fully tested before being used operationally.



SYSTEMS DEVELOPMENT AND CONTROL

File conversion: Before the new system becomes operational, master files should be set up completely and accurately. This process is referred to as conversion checks.

Authorization: Each system development stage should be reviewed by a responsible officer in the EDP department and it must be approved by the steering committee or board of directors

Conclusion: It is important to consult with auditors because they would want to ensure that sufficient control is present in the new system to maintain reliable accounting records.



ADMINISTRATIVE CONTROLS

- a) **Division or segregation of duties:** Data processing staff should not initiate transactions or authorize normal transactions while users should not operate the computer by self to process transactions.

- b) **Control over computer operators:** There should be control over computer operators using manual with details of standard procedures to be followed always. There should be frequent and independent review of computer usage by references to clerical and machine logs. There should be rotation of operators' duty and a minimum of two operators per shift.



COMPUTER ASSISTED AUDIT TECHNIQUES.

Computer Assisted Audit Techniques (CAATs) is the tool which is used by the auditors. This tool facilitates them to make search from the irregularities from the given data. With the help of this tool, the internal accounting department of any firm will be able to provide more analytical results



ADVANTAGES OF CAATS

- ❖ Independently access the data stored on a computer system without dependence on the client.
- ❖ Test the reliability of client software, i.e. the IT application controls (the results of which can then be used to assess control risk and design further audit procedures).
- ❖ Increase the accuracy of audit tests and
- ❖ Perform audit tests more efficiently, which in the long-term will result in a more cost effective audit.



DISADVANTAGES OF CAATS

- ❖ CAATs can be expensive and time consuming to set up, the software must either be purchased or designed (in which case specialist IT staff will be needed).
- ❖ Client permission and cooperation may be difficult to obtain.
- ❖ Potential incompatibility with the client's computer system.
- ❖ The audit team may not have sufficient IT skills and knowledge to create the complex data extracts and programming required.
- ❖ The audit team may not have the knowledge or training needed to understand the results of the CAATs.
- ❖ Data may be corrupted or lost during the application of CAATs.