

# ASSIGNMENT No. 01

## Auditing (5417) BS ACCOUNTINGD FINANCE

### Spring, 2025

#### Q. 1 Define the scope of Auditing and describe its Techniques. (20)

Accounting is process of recording, measuring, and communicating economic information to various users. The main goal of accounting is to provide a company with clear, comprehensive, and reliable information about its economic activities and status of its assets and liabilities. This information is presented in the form of accounting reports like the balance sheet, income statement, statement of changes in equity (also called shareholders' equity statement), and statement of cash flows (also called cash flow statement). By means of accounting reports it is possible to perform the following (list non-inclusive):

- Understand and re-allocate internal resources of the company to ensure its financial stability
- Review profitability of the company's economic activities
- Understand the company's cash inflows and outflows
- Verify conformity of a company's economic activities to government regulations

Internal users of accounting reports are managers, owners, and employees. External users of accounting reports are investors, creditors, and government.

#### Audit

Audit is independent appraisal performed by an independent expert of an activity or event. There are operational, technical, ecological and other types of audit. Most commonly, nevertheless, this term refers to audits of financial statements. Audit of financial statements is the process of examining the financial statements and the underlying records of the company in order to render an opinion as to whether the statements are fairly presented. Most commonly financial audits are performed on a company's request for the benefit of financial information users (i.e. internal and external). Auditors analyze and compare accounting reports and confirmation documents as well as verify conformity of a company's accounting with established standards and regulations (e.g. US GAAP, IFRS). Therefore, the main goal of an audit is to perform thorough evaluation of a company's financial records and reports and provide a company with improvement recommendations based on that evaluation. As we can see, accounting provides financial information to users of such information, and auditing is a means to ensure such information is reliable and comforts with established rules and regulations.

Some accounting errors are so common that categories were created for them. Certain mistakes are input errors while others are procedural in nature. Accounting errors are material if they affect the economic decision taken by users of the information. As such, procedural errors, such as mistreatment of expenses are usually material and significant. There are three basic categories of errors in accounting: (i) errors of commission, (ii) omission and (iii) principle.

#### Objectives and scope

Auditing is a service function. It is organized and operated primarily for the purpose of conducting audits, in accordance with professional standards, of systems of internal control, including operational controls and information systems processing applications and techniques. The evidential matter gathered from these audits forms the basis for furnishing opinions and other relevant information to affected members of management and the board of directors, or audit committees thereof, as is necessary in the opinion of the chief auditor and performing members of the audit team. Opinions and other information furnished may attest to the adequacy of internal control, the degree of compliance with established policies and procedures, and/or their effectiveness and efficiency in achieving

organizational objectives. They may also recommend cost effective courses of action for management to consider in eliminating unnecessary risks identified by the audits.

### Conducting proactive fraud

The scope of internal auditing within an organization is broad and may involve topics such as an organization's governance, risk management and management controls over: efficiency/effectiveness of operations (including safeguarding of assets), the reliability of financial and management reporting, and compliance with laws and regulations. Internal auditing may also involve conducting proactive fraud audits to identify potentially fraudulent acts; participating in fraud investigations under the direction of fraud investigation professionals, and conducting post investigation fraud audits to identify control breakdowns and establish financial loss.

Internal auditors are not responsible for the execution of company activities; they advise management and the Board of Directors (or similar oversight body) regarding how to better execute their responsibilities. As a result of their broad scope of involvement, internal auditors may have a variety of higher educational and professional backgrounds.

The Institute of Internal Auditors (IIA) is the recognized international standard setting body for the internal audit profession and awards the Certified Internal Auditor designation internationally through rigorous written examination. Other designations are available in certain countries. In the United States the professional standards of the Institute of Internal Auditors have been codified in several states' statutes pertaining to the practice of internal auditing in government (New York State, Texas, and Florida being three examples). There are also a number of other international standard setting bodies.

### Q. 2 Define Audit and describe its types in detail. (20)

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### Types of audit

Audits protect your company from fraud and negligence. They also identify performance improvements and verify the accuracy of your financials. Clarify the audit's scope and objectives for your auditors before they begin so they can plan their work. They will customize their procedures to obtain information meant to corroborate the expected results. Help them as needed during the audit, review their final report and make any recommended changes based on their findings.

### Planning

Describe your company and industry to your auditors. Give them an overview of your business model and procedures. They will perform preliminary analyses to assess business risk and potential for fraud, perhaps comparing budgeted amounts to actual expenses to identify discrepancies that warrant further study. Auditors also will review your internal control systems to identify the areas of highest risk, such as handling cash or processing payments. They will plan the rest of the audit to address the greatest risks and concerns.

### Testing Controls and Transactions

Auditors will test internal controls and review the accuracy and propriety of transactions. They may count cash, inventory or other resources to confirm your counts. Auditors also may compare transaction documents with your books, ensuring the correct sales price has been recorded. They may examine specific entries in your books to check if you properly wrote off bad debt, for example. Auditors also may watch you or your employees to ensure cash is secured and sensitive information isn't exposed.

### Testing Balances

Auditors analyze your company's performance, using financial ratios and statistical sampling. For example, they may compute the proper total and taxable wages, using your earnings records, and compare those with the figures you reported. Auditors also will inspect documents for accuracy, comparing the wages you should have reported with those reported on tax forms for individual employees and on your federal tax filings. They will compare account balances in your books with those on your bank statements.

### Reporting

Auditors will draft a report summarizing their findings, informing you of any risks and urging you to rectify any vulnerabilities or errors. They will review the draft with you before giving you a final report, accounting for any comments you may have or events that may have occurred since the audit. Your board of directors, investors, lenders and other stakeholders may want to review the final report with you.

### About audit program

An audit is a formal check of financial accounts of an individual, business or organization. An internal audit is conducted by members of the same organization or business, and an external audit may be conducted by a regulatory agency or governmental agency. There are six specific steps in the audit process that should be followed to ensure a successful audit.

### Requesting Documents

After notifying the organization of the upcoming audit, the auditor typically requests documents listed on an audit preliminary checklist. These documents may include a copy of the previous audit report, original bank statements, receipts and ledgers. In addition, the auditor may request organizational charts, along with copies of board and committee minutes and copies of bylaws and standing rules.

### Preparing an Audit Plan

The auditor looks over the information contained in the documents and plans out how the audit will be conducted. A risk workshop may be conducted to identify possible problems. An audit plan is then drafted.

### Scheduling an Open Meeting

Senior management and key administrative staff are then invited to an open meeting during which the scope of the audit is presented by the auditor. A time frame for the audit is determined, and any



timing issues such as scheduled vacations are discussed and handled. Department heads may be asked to inform staff of possible interviews with the auditor.

### Conducting Fieldwork

The auditor takes information gathered from the open meeting and uses it to finalize the audit plan. Fieldwork is then conducted by speaking to staff members and reviewing procedures and processes. The auditor tests for compliance with policies and procedures. Internal controls are evaluated to make sure they're adequate. The auditor may discuss problems as they arise to give the organization an opportunity to respond.

### Drafting a Report

The auditor prepares a report detailing the findings of the audit. Included in the report are mathematical errors, posting problems, payments authorized but not paid and other discrepancies; other audit concerns are also listed. The auditor then writes up a commentary describing the findings of the audit and recommended solutions to any problems.

### Setting Up a Closing Meeting

The auditor solicits a response from management that indicates whether it agrees or disagrees with problems in the report, a description of management's action plan to address the problem and a projected completion date. At the closing meeting, all parties involved discuss the report and management responses. If there are any remaining issues, they're resolved at this point.

### Q. 3 Explain the following; (10+10)

#### i. Scope and objects of auditing.

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## ii. What are the major qualities of an auditors?

### Qualities of an auditor:

To be successful, an auditor should possess certain desirable qualities, besides having his formal qualification. His qualification requires that he should be a qualified chartered accountant. Besides, he should possess the following qualities: -

1. Tactfulness
2. Cautious approach
3. Firmness
4. Good temperament
5. Integrity etc.



He should be tactful in doing the job of auditing. While doing auditing, he should be cautious. He should have integrity, and independence. He should possess the knowledge of common business laws. Like mercantile law partnership act, sale of goods act etc. He should possess a thorough knowledge of taxation provisions prevalent in the country. An auditor is required to critically comment upon the financial statements. He should possess requisite expert in that field. He should occupy the position of an expert in that field. He should have thorough knowledge of all accounting principles and procedures. He should also know the ways and means in which the business is being conducted. By possessing these qualities, he can become a successful and effective auditor.

Auditors are most often employed in the Accounting or Financial fields, though other fields might also utilize Auditors. An Auditor might be responsible for examining a wide variety of data, facts and figures, and other information, toward providing verification and integrity of the business at hand.

#### Some examples of Auditor duties include:

Verification of Payroll records, insurance claims and resolutions, Bank transactions, bookkeeping practices and figures, and other similar responsibilities. Auditors must be honest, trustworthy, organized, not afraid of details, statistics or numbers, and must be keenly involved in the business at hand, to ensure accuracy and integrity of the auditing process.

Auditors must also be comfortable with mathematics, statistical analysis, problem solving, and other similar disciplines.

- Examines and analyzes accounting records to determine financial status of establishment and prepares financial reports concerning operating procedures: Reviews data regarding material assets, net worth, liabilities, capital stock, surplus, income, and expenditures.
- Inspects items in books of original entry to determine if accepted accounting procedure was followed in recording transactions.
- Counts cash on hand, inspects notes receivable and payable, negotiable securities, and cancelled checks.
- Verifies journal and ledger entries of cash and check payments, purchases, expenses, and trial balances by examining and authenticating inventory items.
- Prepares reports for management concerning scope of audit, financial conditions found, and source and application of funds.
- May make recommendations regarding improving operations and financial position of company.
- May supervise and coordinate activities of auditors specializing in specific operations of establishments undergoing audit.
- May audit banks and financial institutions and be designated Bank Examiner.
- May examine company payroll and personnel records to determine worker's compensation coverage and be designated Payroll Auditor.

#### Q. 4 Define internal control and explain the methods used by an auditor to review the internal control procedures used by his clients. (20)

The relationship of the internal auditor and statutory auditor can be summed up as follows:

1. As per manufacturing and other companies order 1988 issued under section 227 of the companies act the statutory auditor has to comment upon the effectiveness and suitability of internal audit system laid down by the management.
2. To discharge this responsibility: statutory auditor should evaluate the internal audit system he should evaluate the strength of the internal audit staff, their qualification and experience.
3. Evaluation of the actual work of internal auditor "After studying the internal audit system and structure actual work of the internal auditor should also be evaluated. Statutory auditor has to make use of the work of internal auditor. This he can do only when he himself puts faith in the work of internal auditor.

4. Relying on the work of internal auditor "statutory auditor has to decide that up to what extent he can rely upon the work of the internal auditor. This will decide the extent of his own checking. If he feels that internal auditor has properly done his work he can reduce the extent of his checking.
5. No reduction in responsibility "Relying on work of internal auditor in no way reduces the responsible for the discharge of his duties as statutory auditor.

Relying on the internal auditor can only reduce the burden of the statutory auditor.

For all his works statutory auditor would remain responsible.

### Differences between Internal Audit and Statutory Audit

An internal audit is conducted by the permanent staff of the same office to detect weakness in system, procedures and for the improvement. But statutory audit is the act of checking books of accounts as per the provision of company act. Both of them check books of account; detect errors and frauds even though they have certain differences which are as follows:

#### 1. Appointment

An internal auditor is generally appointed by the management but statutory auditor is appointed by the shareholders or Annual General Meeting.

#### 2. Legal Requirement

Internal audit is the need of management but it is not legal obligation but statutory audit is the legal requirement.

#### 3. Qualification

An internal auditor does not required specific qualification as per the provision of law but qualification of statutory auditor is specified.

#### 4. Conducting Of Audit

Internal audit is of regular nature but final audit is conducted after the preparation of final account.

#### 5. Status

An internal auditor is a staff who is appointed by the management but statutory auditor is an independent person appointed by the shareholders.

#### 6. Scope of Work

Internal audit is related to the examination of books of accounts and other activities of an organization but statutory audit checks the books of accounts and related evidential documents. So, scope of internal audit is vague but scope of statutory audit is limited.

#### 7. Removal

Internal auditor can be removed by the management but statutory auditor can be removed by the annual general meeting only.

#### 8. Remuneration

Internal auditor is appointed by the management; so remuneration is fixed by the management but remuneration of statutory auditor is fixed by the shareholders.

#### 9. Report

Internal auditor needs to give suggestions to improve weakness but no need to present report but statutory auditor requires to prepare report after the completion of work on the basis of facts found during the course of audit and present such report to the appointing authority.

### Internal auditor report:

An audit report is a written opinion of an auditor regarding an entity's financial statements. The report is written in a standard format, as mandated by generally accepted auditing standards (GAAS). GAAS requires or allows certain variations in the report, depending upon the circumstances of the audit work that the auditor engaged in. The following report variations may be used:

- A clean opinion, if the financial statements are a fair representation of an entity's financial position.
- A qualified opinion, if there were any scope limitations that were imposed upon the auditor's work.
- An adverse opinion, if the financial statements were materially misstated.



- A disclaimer of opinion, which can be triggered by several situations. For example, the auditor may not be independent, or there is a going concern issue with the auditee. The typical audit report contains three paragraphs, which cover the following topics:
  1. The responsibilities of the auditor and the management of the entity.
  2. The scope of the audit.
  3. The auditor's opinion of the entity's financial statements.

An audit report is issued to a user of an entity's financial statements. The user may rely upon the report as evidence that a knowledgeable third party has investigated and rendered an opinion on the financial statements. An audit report that contains a clean opinion is required by many lenders before they will loan funds to a business. It is also necessary for a publicly-held entity to attach the relevant audit report to its financial statements before filing them with the Securities and Exchange Commission.

Statutory auditors, in most of the countries are referred to the external auditors or the external public accountants who are certified. A statutory auditor is an external or outside service supplier who has the responsibility to certify the financial statements in accordance to specific professional auditing standards like the ACA, ACCA, INSTOSAI standards.

The most common and widely used external audit standards are the International Standards on Auditing (ISA) of the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants and the US GAAP which is developed by the American Institute of Certified Public Accountants.

## Overview

A statutory auditor is an auditor who is usually a part of the internal audit system that operates in one of the following areas and sometimes he may operate in more than one area. The following areas are:

Reviewing of the accounting and all the related internal controls. Therefore, the function of a statutory auditor is clearly defined where he is usually given the specific responsibility to review the accounting systems and the internal controls related to it and also to monitor all their operations while the management has the work of seeing the overall accounting system and its adequacy.

Reviewing of the financial as well as operating information that includes various functions like identifying, measuring, classifying and reporting all such information that specifically enquire individual items that includes detailed and thorough testing of transactions, balances and procedures.

A statutory auditor may have to examine the efficiency, effectiveness and economy of operations that may also include all the non financial controls.

Statutory audit refers to a legal requirement to review the financial records of a company or of the government, in order to check its fairness and accuracy. The use of statutory audit is not different from any other type of audit. Like other audits, the main purpose of the statutory audit's is to find out whether the representation of the financial position of the organization is fair and accurate by studying the financial transactions, bank balances and book keeping records of the organization.

## Principles and application of internal control

### Accounting Records

Accurate and timely accounting records are necessary for directors and managers to determine operating results and to be able to make adjustments when necessary in their operations. They are necessary for satisfying external reporting requirements, for government regulators to determine compliance with laws and regulations and for investors to make sound investment decisions. Accurate and timely accounting records allow for the efficient and effective management of a business. Without timely and accurate accounting records confusion and chaos would result.

This is where internal controls come into play. A strong internal control system is necessary to provide reasonable assurance of accurate and timely accounting records.

### Internal Controls sponsoring

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with laws and regulations. The aggregate control system of the organization as defined by COSO includes accounting controls but goes much further to include administration, operations and governance. All five components apply to the entire organization, not just the accounting and financial reporting functions.

Properly designed internal controls provide reasonable assurance that objectives will be met. There cannot be absolute assurance because there are inherent limitations to internal controls and at some point the cost of tighter and/or more controls outweighs the benefit of those incremental control procedures. The concept of reasonable assurance implies a high degree of assurance, limited by cost/benefit considerations and other inherent limitations.

Since internal control involves human action, there is always the possibility of errors in processing or judgment. Internal controls can also be overridden by employee collusion or coercion by top management.

### Considerations

Because these internal control audits are mandated by law and have been made a part of the SEC reporting package, they are very important to management, regulators and the investing public. Internal control audits verify that proper internal controls are in place and are functioning as intended.

### Definition of Audit Note Book

E.L. Kohler formulated a detailed definition for the term. According to him, "Audit note book is a record, used chiefly in recurring audits, containing data of work done and comments outside the regular subject matter of working papers. It generally contains such items as the audit programme, notations showing how sections of the audit are carried out during successive examinations, information needed for the auditor's office and for staff administration, personnel assignment, time requirements and notations for use in succeeding examination". Audit note book is maintained by the audit assistant to note down to all those unclear matter which he may come across in the course of audit and on which he requires further clarification and explanation. It contains day to day work performed by the audit staff on any particular day. Notes about all types of errors, difficulties and un cleared point, etc. are recorded in audit notebook. Audit notebook is a diary on which auditor scribble down all important inquiries to avoid the possibility of unquestioned material facts.

### Importance of Audit Note Book

Justice William throws light on the importance of audit notebook in the following words: The audit notebook that contained detailed information proved to be very helpful to the auditor in every critical moment. For preparing the audit report it is very useful for that auditor. In case of negligence charge against the auditor, but note book good evidence can be presented. It may be also used for future guidance and reference. It also enables to auditor to know that what work his assistant at each audit has done.

### Objectives of Audit Note Book:

1. To know about the nature of business. Detection and prevention of frauds and errors effectively.
2. To make the future audit work easier.
3. To know the facts where clarification and explanation are essential.



4. To check the list of debtors and creditors.
5. To present as a proof by the auditor to clearance over the cases.

### Contents of Audit Note Book:

1. A copy of audit program.
2. The nature of business and important documents relating to the business.
3. The name of the clients and audit year.
4. A list of books of accounts.
5. Name of principal officers, their duties and responsibilities.
6. Accounting and financial policies followed by the business.

#### Advantages of Audit Note Book

##### 1. Audit Report

The audit notebook is helpful to prepare audit report. The auditor can record the weakness of accounting records. The queries not properly answered are started in the audit report when the auditor is satisfied he can submit a clear report.

##### 2. Staff Honesty

The audit notebook is used to determine the integrity and honesty of audit clerks. The moral and ethical value can be examined through audit work. When a person completes his work in time. Time period auditor can appreciate him. If there is pending work after the expiry of time period, he can be held responsible for it. The audit staff must be honest in his work.

##### 3. Helpful For Memory

The audit notebook is help to keep things fresh in memory. The auditor can read the book on daily basis. He can note the weakness on fingertips. The auditor can retain the data in his memory for a longer period of time. He can ask the management to clear the doubtful points before preparing audit report.

##### 1. Reference

The audit notebook is useful for reference. In future it can provide information to the audit staff. The past data gives an insight into business matters. The auditor can note the changes. He can form an opinion about the changes in the nature and size of the business.

##### 5. New Auditor

The audit notebook is useful for new auditor. They can see the weakness of previous years. The old weak points may not be repeated this year.

##### 2. Court Cases

The audit notebook is helpful to defend an auditor in court cases. The people can go to court of law in order to fix liability for negligence of duty. The audit notebook is a written proof of work performed by an auditor.

### Q. 5 Define vouching and explain its techniques and application to the books of accounts.

#### VOUCHING:

It means to test the truth of items appearing in the books of original entry. It is an important part of an auditor's duty to certify as correct the transactions recorded in the Looks of accounts. The

Accountant of a business is responsible for passing entries in the books of prime entry. The question arises how and on what basis such entries have been passed. The auditor's primary duty is to check these entries and only then certify the accounts as correct and free from any error or fraud.

#### DEFINITION:

A careful examination of all original evidence such as invoice receipt of correspondence minutes, contracts etc. Vouching is very useful in proving the accuracy of the entries in the books of accounts. It also indicates about that transaction, which is omitted from the books of account.

#### IMPORTANCE:

Vouching is called the essence of auditing. So audit is not possible without vouching. The object of vouching is to find out the accuracy of the entries appearing in the books of accounts and detect that no entry has been omitted from the books of account.

#### PRINCIPLES OR TECHNIQUES OF VOUCHING

At the time of vouching auditor should keep in view the following important principles in his mind.

##### 1. ARRANGED VOUCHERS:

In the books of accounts the vouchers are based an entry. A voucher is helpful to support any transaction, which may be cash memo fill, voucher, ticket or others.

##### 2. CHECKING OF DATE:

The voucher date can also be checked; it must be related to the current year. The date of the last or future year must not be adopted.

##### 3. COMPARE THE WORDS AND FIGURES:

The auditor should satisfy himself amount written on the vouchers, its figures and words are same or not.

##### 4. CHECKING OF AUTHORITY:

The vouchers are considers correct only when the proper authority signs on them. For the approval of the dealing the owner or the management must put the signatures for the approval of dealing if the vouchers are without the signatures of the proper authority. They are not considers the true.

##### 5. CUTTING OR CHANGE:

There should be no changes in the vouchers. Any person for making the fraud can change the time, date amount, and name of concern. So, these changes cannot be acceptable till the approved authority has made the signature.

##### 6. TRANSACTION MUST RELATE TO BUSINESS:

For the correctness of the vouchers it is necessary that it relate with the business Concern. The vouchers must be in the name of the business and also the manager. If it does not the vouchers are not acceptable and doubtful.

##### 7. CASE OF PERSONAL VOUCHERS:

The auditor should not accept the voucher in personal name. There is a chance that an officer of the company has purchased any item in his personal capacity.

##### 8. CHECKING OF ACCOUNT HEAD:



Auditor must be satisfied about the head of account in which cash is deposited and drawn. He should examine the documentary evidence in these regards.

#### 9. REVENUE STAMPS:

For the stamps, the stamps act 1899 is applicable while fixing the revenue stamps. The stamps are required according to the valuation of the amount or cash memo. There is no need of vouchers if amount is less than twenty rupees.

#### 10. CASE OF CANCELLED VOUCHER:

The auditor should not accept the cancelled vouchers, because it has already served the purpose of payment. There will be a danger of double payments, if it is accepted.

#### 11. IMPORTANT NOTES:

For finding the correct decision, the auditor can also take help from the working papers of the previous year and others paper or note related to business and available with the management.

#### 12. MINUTES BOOK:

When the meeting of shareholders is held, all the resolutions and decisions of the directors and shareholders are recorded in the minute's book. This minute's book must be examined by the auditor. He has to check that these decisions have been implemented in the books of accounts or not.

#### 13. BYLAWS:

In case of company the article of association and memorandum are basically the rules & regulations. But on the other hand in the societies and clubs the bylaws are used to determine the powers of management. The auditor goes through these rules and regulation to find the true & fair view.

#### 14. AGREEMENTS:

The auditor must examine all the related papers of the business such as the agreement, correspondence and others. The basic information can be received to the auditor by such papers.

#### 15. DEED OF MORTGAGE:

Some times, you're the sale or purchase of any assets, the management can enter into the agreement is prepare in this case. If the agreement is prepare in this case. If the agreement is made for a loan against the immovable property then the mortgage deed is signed. It is compulsory for the auditor to study the content of the deed.

#### Application to the books of accounts vouching

Vouching is the process of matching documentary evidence of an account balance or a transaction with the details recorded in accounting records and provides evidence as to the totality, validity or correctness of an account balance or a transaction. Actually this documentary evidence is called a voucher. Whenever an auditor is asked to provide the evidence of the validity, completeness and accuracy of a transaction, the auditor gathers evidence that details of the account balance, transaction that has been recorded in the accounting records and usually it is supported by a documentary evidence i.e. Voucher.

#### Example

For example, the auditor acquires evidence relating to the validity, completeness and accuracy of an item such as sales recorded in a company's inventory records by vouching from details recorded in the inventory records (e.g. Name of the customer, date of the sale, items sold and the total amount of the

transaction) to details on suppliers' invoices. Vouching is necessary for every registered organization so that the record should be kept with the documentary evidence. Whenever auditor conducts the audit he should not face any problem and specially vouching is considered important because it prevents from frauds that could have been done by any one from within the organization. Vouching is sometimes referred to as verification of the accounting records.

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