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FOR-LNMU -B.com part -3rd Paper-viii - Principles of Auditing

Unit I

Introduction of Auditing

❖ 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.

According to - L.R.Dicksee

“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.”

According to - R.K. Mautz

“Auditing is concerned with the verification of accounting data determining the accuracy and reliability of accounting statements and reports.”

According to R.E.Schlosser

“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.”

❖ 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.

❖ Importance of Auditing

Importance of auditing can be judged from the fact that even those organizations which are Not covered by companies Act get their financial statements audited. It

has become a necessity for Every commercial and even non- commercial organization.

The importance of auditing can be summed In following points:

- 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.
- f. Long and short term creditors depend on audited financial statements while taking Decision to grant credit to business houses.
- g. Taxation authorities depend on audited statements in assessing the income tax, Sales tax and wealth tax liability of the business.
- h. Audited accounts are useful for the government while granting subsidies etc.
- i. It can be used by insurance companies to settle the claims arising on account of loss By fire.
- j. Audited accounts serve as a basis for calculating purchase consideration in case of Amalgamation and absorption.
- k. It safe guards the interests of the workers because audited accounts are useful for Settling trade disputes for higher wages or bonus.