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# Errors and Frauds in Financial Transactions: Auditors Opinion

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## Abstract

Scams like WorldCom and Enron diverted the attention of the whole world towards the auditing problem why errors and frauds remain undetected in spite of auditing books, accounts and records of a business enterprise. The Satyam scandal has further made the lawkeepers more vigilant and cautious. Occurrence of errors and frauds in the financial statements has become a persistent problem for the regulating bodies such as SEBI, ICAI, etc. However, there is no dearth of rules and regulations in form of standards on Auditing and accounting at the national as well as international level. It is becoming difficult to put a full stop on the existence of incidences entailing errors and frauds. The objective of this paper is to identify the transactions which are more prone to errors and frauds and to locate the type of errors and frauds which are frequently discovered by auditors while conducting the audit and identifying error or fraud that is most difficult to detect. Moreover, the paper also attempts to determine the suitable action to be taken by auditors in case of critical or awkward situations. This has been done with the help of a structured questionnaire sent to 200 members of the Institute of Chartered Accountants of India.

Key Words: Audit, Errors and Frauds, Status of Auditor, Auditor’s Prime Responsibility and Management Involvement

## Introduction

In accordance with SA 200 (Revised), the overall objective of an auditor entails securing reasonable assurance that financial statements are free of material misstatements resulting either due to errors or frauds so that the auditor is able to express an expert opinion about the quality of financial statements. Errors are generally innocent and unintentional. On the other hand, frauds are intentional and preplanned. But accuracy of financial statements is affected in both of the cases. However, consequences of frauds are much more serious than those of errors. Sometimes, errors which appear to be innocent at the first sight might discover to be due to fraudulent manipulations later on. Thus, an auditor is required to be equally careful and diligent in inspection of errors as well as frauds.

In this backdrop, the rest of the paper is divided into five more Sections. Section II presents the literature review. Section III discusses the meaning and concept of the terms “errors and frauds” and highlights the position of the auditor in this context. Research Methodology is outlined by Section IV. Empirical findings and results have been manifested with the help of Section V. Lastly, the conclusion and recommendations have been mentioned in Section VI.

## Literature Survey

Wright, Krishnamoorthy and Cohen (2002) conducted a study to analyze whether auditors are sufficiently sensitive to the type and strength of corporate governance when conducting an audit. Agrawal and Chadha (2004) examined whether certain governance mechanisms are related to the incidence of an earnings restatement by a firm. Ghosh and Kallapur (2004) investigated investor perceptions proxied by earning response coefficients (ERCs), of auditor independence-in-appearance as a function of audit and non-audit fees. Desai (2006) advanced research in internal audit (IA) evaluation by developing an IA assessment model that considers interrelationship among specific factors used by external auditors when evaluating the strength of the IA function. Hoitash and Hoitash (2007) provide a detailed examination of the association of audit fees with internal control problems disclosed by public companies under provisions of Sarbanes-Oxley Act which made disclosure of internal control problems mandatory.

Krishnamoorthy, Cohen and Wright (2008) developed a case in order to alert students to the importance of non-financial information in audit process; to develop students ability to search for relevant financial and non-financial information in audit planning process; and to emphasize the importance of maintaining professional skepticism and to resist the natural tendency to over-rely financial information when conducting the financial statement audit. Aurelia (2008) stated that the internal audit concept is not tridimensional irrespective of property forming the capital bears, the entity organization, and the operating system-private-public-banking. Its goal is unique: to ensure the degree of control upon the operations for the entity, to guide the entity in order to improve its operations and to contribute to the adding of a plus value. Cohen, Krishnamurthy, and Wright (2008) presented three alternative theoretical prospectives that help in better understanding corporate governance: resource dependence (a strategic prospective), management hegemony (an entrenchment prospective), an institutional theory (a legitimation prospective). Bhayani (2009) states that capital market regulator, Securities and Exchange Board of India (SEBI), which was investigating insider trading charges against Satyam's promoters and some institutional investors, has widened its inquiry to cover the role of banks and the internal auditor. Murlidharan (2009) criticizes the present system of internal audit and observes that the system of appointment of auditors by a dispassionate agency in the enterprises be the ideal, but till this issue is hammered out, Murlidharan (2009, 2010) argued that dual audit may be a second solution. Gupta (2011) critically examined the definition of audit with special reference to AAS1 (SA 200) issued by ICAI. Gupta and Murthy (2012) examined the importance of internal control systems in Indian enterprises.

## Meaning and Concept

The primary objective of an auditor is considered to express an expert opinion about the quality of financial statements although prevention and detection of errors and frauds is the secondary goal of an auditor while checking the authenticity of books of accounts. Usually, errors are innocent and unpremeditated while frauds are deliberate and preplanned. Authenticity of financial transactions is affected in the cases of both errors and frauds although aftermaths as a result of frauds are proved to be much severe. Although it is also true that errors that appear to be innocent at the first instance might discover to be due to fraudulent manipulations afterwards. Therefore, an auditor must remain equally careful and diligent in inspection of errors as well as frauds throughout the conduct of his audit task.

## Errors

The term “error” in audit context refers to unintentional mistakes in the preparation or presentation of financial information. AAS 4, “Auditor’s Responsibility to Consider Fraud and Error in an Audit of Financial Statement”[1] states that errors are unintentional misstatement or omission of disclosure of amounts in the financial statements. The errors, in general, may be of following types:

### *1. Clerical Errors*

Errors in recording, posting, totaling and balancing are called clerical errors. Clerical errors can further be subdivided as: (I) errors of omission and (ii) errors of commission. Errors of

[1] AAS 4 or SA 240 has been revised and is known as SA 240 (Revised) “The Auditor’s Responsibility relating to Fraud in Audit of Financial Statements”

omission are the errors where a transaction is omitted wholly or partially in the books of account. For example, goods sold to one party were omitted to be recorded in the original book of entry while in other case, goods sold are recorded properly but omitted to be posted in the ledger and so on. On the other hand, error of commission include wrong posting of amounts, posting on the wrong side, posting in wrong account, error in totaling and balancing; errors in carry forward totals to trial balance and so on. For example, a purchase of Rs. 10,000 was entered in the purchase book at Rs. 1000; goods sold to one party were wrongly posted to the debit of another party and so on. Clerical errors may affect or may not affect trial balance.

***2. Errors of Principle***

Error of principle occurs when generally accepted accounting principles are not observed while recording any transaction in the books of account. For example, wrong account head being chosen or recording of capital expenditure as revenue or vice versa. Such an error is not disclosed by trial balance or by routine checking. It can only be detected by a searching enquiry or independent checking.

***3. Compensating Errors or Off-setting Errors***

Compensating error or off-setting error is counter-balanced by another error or errors. In other words, compensating errors are those errors that result in compensating the effect of other errors. For example, if a person’s account is to be debited by Rs. 100, he is debited instead by Rs. 200 and other person who was to be debited by Rs. 200, is debited by Rs. 100. These errors do not affect trial balance and can be located by checking totals, postings and castings. Thus, it is difficult but not impossible to locate these types of errors.

### *4. Errors of duplication*

Errors of duplication occur when the same transaction is recorded twice in the books of original entry, and hence, are also recorded twice in the ledger accounts. These do not affect trial balance. Thus, agreement of trial balance always does not indicate that there is no error.

## Frauds

Fraud means false representation or entries made intentionally or without having belief in its truth with a view to defraud somebody. As per AAS 4 (SA 240, Revised), fraud refers to intentional misstatement or omission of disclosure of amounts in financial statements. Management, employees or third parties may get involved in committing fraud in order to obtain illegal advantage or personal gains. Frauds are generally committed in form of either misappropriation of assets that may be called “employee fraud” or manipulation of accounts that may be referred as “management fraud”. Embezzlement of cash, misappropriation of goods and fraudulent manipulation of accounts are the three chief ways in which frauds can be perpetrated as discussed below:

### *1. Embezzlement of Cash*

Manipulation of money is found more in big business houses in comparison to small proprietary businesses because of direct control that is missing in big entities. A system of internal checks becomes essential in large business firms. Thus, an auditor is required to deal with cash transactions more carefully. Cash can be misappropriated in the following ways:

a) Omitting to enter cash which has been received;

b) Entering lesser amount than what has been actually received;

c) Making fictitious entries on the payment side of the cash book or;

d) Entering more amounts on the payment side of the cash book than what has actually been received.

The auditor should check the debit side of the cash book with the rough cash book, salesmen's reports, counterfoils of receipt books, agent's returns and other original records to discover frauds mentioned in (a) and (b) above while frauds under (c) and (d) can be discovered by reference to vouchers, wage sheets, salary book, invoice and other such documents.

***2. Misappropriation of Goods***

Frauds are also committed in respect of goods which are known as misappropriation of goods. These types of frauds are most difficult to detect specially in case of lesser bulky goods with higher prices. Proper methods of keeping account with regard to purchase and sale, stocktaking, periodical checking of stocks, comparing of percentages of gross profits to sales of two periods is necessary to avoid misappropriation of goods.

***3. Fraudulent Manipulation of Accounts***

Fraudulent manipulation of accounts is more difficult to detect as it is usually committed by directors, managers or other responsible officials with an object of:

i. Showing more profits than they are to:

a) If they get commission on profits, they get more commission;

b) Maintaining confidence of shareholders by reflecting efficiency due to increased profits;

c) If they hold shares, they may sell them at high price by declaring higher dividends;

d) To secure further credit by showing better financial position than actually it is;

e) To attract more subscribers for the sale of shares of the company.

ii. Showing lesser profits than actually they are in order to:

a. Purchase shares in the market at lower price;

b. To reduce or avoid payment of income tax;

c. To give a wrong impression about the success of the business to the competitors.

iii. Falsification of accounts may be resorted by:

a. Providing more or less depreciation in accordance with set objective;

b. Showing fictitious sales or purchases or returns to increase or decrease the figure of profits as per the case may be;

c. Utilization of secret reserves during the period in which concern has earned lower profits without disclosing this fact to share holders;

d. By sharing revenue expenditure to capital account or vice versa or;

e. By crediting the revenue account with the income which will be received in next year and not crediting the profit and loss account with the income which has accrued but not received.

Such frauds are very difficult to detect as they are committed by the people at the helm of the affairs who are presumed to be trustworthy, honest and responsible and therefore, no suspicion falls on them. They are very cleverly made and, as such, the auditor should be very careful in detecting such frauds. He should carry out the routine checking and vouching most carefully and make searching, tactful and intelligent inquiries.

**Status of Auditor**

The auditor carries out necessary checks before expressing opinion on truth and fairness of financial position and operating results of an entity as reflected in financial statements. The auditor seeks to insure that there is no material misstatement of financial information arising from errors or frauds. However, there is possibility that some material misstatement of financial information arising from errors and frauds may creep in the financial statements. The misstatement may be subsequently found out which can lead to raised suspicion on the performance of an auditor. There are certain limitations as to the audit. First, the auditor cannot check each and every item of financial transactions. He applies test checking of material items. The test nature of audit involves inherent risk associated with it. Second, the evidence, he relies, are only indicative and not conclusive in many of the cases. Third, it is the responsibility of the management to introduce such an in-built control system in the operational and accounting system as to reduce the chance of error and fraud happening. Even the management can not completely eliminate the happening of errors and frauds; it can only reduce their occurrences. Fourthly, sometimes, the management may flout its good conscience and make false representations to the auditor in respect of matters for which auditor has no other mean of checking. Finally, fraud committed with ingenuity is difficult to be detected within a limited period of audit checking. These types of instances hinder the auditor in his checking to detect errors or frauds that may affect the financial information materially.

The position of an auditor with regard to errors and frauds can be summarized as follows:

1. It is the responsibility of the management to prevent errors and frauds.
2. The auditor is not liable for any subsequent discovery of misstatement of any financial information resulting from errors and frauds if he has carried out his duty in accordance with generally accepted auditing practices.
3. If he discovers some errors and frauds during the audit, he must see that errors are corrected and the effect of frauds on financial information of the financial statements should be properly reflected. He must also bring to the notice of the concern, the occurrence of error and fraud at the earliest.

4. The auditor need not sniff for error and fraud. But, if he smells something about it, he should not leave them carelessly.
5. He should enlarge his extent of checking and modify checking procedures to suit the occasion.

Thus, an auditor can be held responsible in case some error or fraud is located afterwards only if it is proved that he has not performed his duty diligently in accordance with generally accepted auditing standards (Tandon, 2002).

## Research Methodology

The present paper is based upon the study entitled, “Perceptions of Auditors on Various Aspects of Statutory Audit” carried out with the help of a structured questionnaire. The questionnaire was sent to two-hundred members of the Institute of Chartered Accountants of India (ICAI) in all which had firstly been pre-tested by ten members of ICAI. Out of two-hundred questionnaires, one hundred and sixty-eight questionnaires are returned and three questionnaires have not been included in the analysis because of incomplete responses. Thus, analysis has been made on the basis of views of one hundred and sixty-five participant auditors that constitute 82.5 percent response. The study takes into account the responses of chartered accountants who are practicing auditors only or may have experience of both auditing profession and industry. All of the respondents are experienced in statutory audit along with other forms of audit. Information has been collected personally, through internet and by post. The responses have been analyzed on the basis of simple aggregates and percentages with the help of a Microsoft excel worksheet.

## Empirical Results

### *Misstatement of Opening Balance*

Opening balance means that which existed in the beginning of the period, it is the same which was the closing balance in the immediately preceding period and brought forward to current period. Therefore, the opening balance carries the effect of previous year. As per AAS 22 or SA 510, "Initial Engagement: Opening Balance" it is the duty of the auditor to verify and obtain appropriate audit evidence that the closing balances of the previous period are correctly brought forward to the current period. An attempt has been made to judge the views of auditors who participated in the analysis whether cases of misstatement of opening balance are frequent, seldom or none. Table V.1 shows the responses of participants in this respect as follows:

**Table V.1**
**Misstatement of Opening Balance**

| Responses | Number of Respondents | Percent |
|---|---|---|
| 1. Frequent | 19 | 11.52 |
| 2. Seldom | 122 | 73.94 |
| 3. None | 24 | 14.54 |
| Total | 165 | 100 |

Table V.1 depicts that in the opinion of nearly, three-fourths (73.94 percent) of the participants, cases of misstatement of opening balance are rare. On the other hand, more than one-tenth (11.52 percent) of the participants are of the view that such cases are frequent. Cases of misstatement of opening balance are none has been claimed by nearly one-seventh (14.54 percent) of the respondents. Thus, in accordance with the majority of respondents, cases of misstatement of opening balance are rare. It might be due to the reason that corresponding previous year's figures are also presented in current year's financial statements which makes the chances of misstatement of opening balances lesser. As found in the responses, one of the respondent states that possibility of such cases is seldom only when previous audit has been done by another auditor.

***Frequent Error or Fraud***

Some major types of errors or frauds are teeming and lading, understatement and overstatement of accounting figures, submission of false invoices, kiting and kick backs. Under teeming and lading, an employee misappropriates cash received from one customer and then covers the shortage when cash is received from the next customer and hence, delaying of recording the credit of accounts continues. Overstatement and understatement of accounting figures is done in order to serve different management goals such as inflating profits or evading taxes respectively. Kiting takes place in case of inter-bank transfers as transit time involved is misused by cashier to hide his cash defalcation. Submission of false invoices along with supporting documents is done to include fictitious purchases in books of account. On the other hand, kickback may be taken by the personnel involved in purchase from the suppliers on goods or services purchased from them. An attempt has been made to determine the most frequently occurring fraud or error from the point of view of respondents. Table V.2 segregates the responses on the aforesaid basis as given below:

**Table V.2**
**Frequent Error or Fraud**

| **Frauds and Errors** | **Number of Respondents** | **Percent** |
|---|---|---|
| 1. Teeming or Lading | 30 | 18.18 |
| 2. Understatement and Overstatement of Accounting Figures | 72 | 43.64 |
| 3. Kiting | 14 | 8.48 |
| 4. Submission of False Invoices | 32 | 19.39 |

| | | |
|---|---|---|
| 5. Kickbacks | 41 | 24.85 |
| 6. Any Other | 2 | 1.21 |

More than two-fifths (43.64 percent) of the respondents state that understatement and overstatement of accounting figures is the most frequent type of error or fraud as per Table V.2. While, nearly, one-fourth (24.85 percent) of the auditors claim that kickbacks are the most prevailing. Approximately, one-fifth (19.39 percent) of the participants are of the opinion that kiting (inflating balance due to inter-bank transfers) is most frequent. However, no firm opinion is constituted as a result of the study. Still, it is proved that more or less each and every type of fraud or error is prevailing especially understatement and overstatement of accounting figures. As found in the responses, one of the respondents state that claiming of single expenditure more than once is also occurring frequently. On the contrary, one another respondent claim that none of the aforesaid fraud or error is prevalent.

***Payment of Wages***

A big part of gross profits of any entity is attributed to payment of wages or salaries. A number of misappropriations or misallocations of funds are done under this head such as inclusion of dummy names of workers, misappropriations of unclaimed pay cheques, manipulation of time or piece-work records or clerical errors. The present study has attempted to locate most occurring fraud or error in this regard. Table V.3 presents the segregation of responses with regard to most frequent fraud or error in relation to payment of wages as under:

**Table V.3**
**Payment of Wages**

| Errors or Frauds | Number of Respondents | Percent |
|---|---|---|
| 1. Inclusion of Dummy Names of Workers | 80 | 48.48 |
| 2. Misappropriation of Unclaimed | 14 | 8.48 |

| | | |
|---|---|---|
| Pay Cheques | 52 | 31.51 |
| 3. Manipulation of Time and Piece-Work Records | 32 | 19.39 |
| 4. Clerical Errors | 3 | 1.82 |
| 5. Any Other | | |

It is depicted by Table V.3 that nearly, one-half (48.48 percent) of the respondents accept that inclusion of dummy names of workers is found most frequently. While approximately, one-third (31.51 percent) of the participants consider that manipulation of time and piece-work records is most prevailing. On the other hand, nearly, one-fifth (19.32 percent) of the respondents participated in the analysis are of the view that clerical errors are most found with respect to payment of wages. Thus, in accordance with majority of participants, inclusion of dummy names of workers is most prevalent with regard to payment of wages. It may be due to the fact that the system is highly disorganized in cases of daily workers specifically. There is no or weak internal check in relation to appointment of casual workers by contractors and their wage payment subsequently. Other opinions as found in the responses in this respect are:

1. Frauds are committed by maintaining two records, one for actual payments and another for book purpose.
2. None of the errors or frauds is prevailing in this respect.
3. In case of unskilled workers where payment is made by contractors.

***Stock***

Misappropriation of inventory is one of the most common types of errors or frauds. These types of frauds are most difficult to detect specially in case of lesser bulky goods with higher prices. Frauds or errors in relation to inventory are generally found in form of thefts or inventory loss, misappropriation of goods and fictitious invoices. Views of respondents have been judged in terms of most prevailing error or fraud with regard to inventory. Table V.4 displays the views of respondents in respect of most prevailing frauds or errors related to inventory as follows:

**Table V.4**
**Stock**

| Errors or Frauds | Number of Respondents | Percent |
|---|---|---|
| 1. Thefts or Inventory Loss | 67 | 40.61 |
| 2. Misappropriation of Goods | 77 | 46.67 |
| 3. Fictitious Invoices | 29 | 17.57 |
| 4. Any Other | 5 | 3.03 |

It is shown by Table V.4 that nearly, one-half (46.67 percent) of the participants are of the opinion that misappropriation of goods is the most common type of error or fraud in terms of stock. While, more than two-fifths (40.61 percent) of the auditors consider that thefts and inventory loss are most prevalent. Production of fictitious invoices has been found frequently occurring by nearly one-fifth (17.57 percent) of the respondents only. Thus, respondents are indifferent in between misappropriation of goods and thefts or inventory loss. It might be because of the reason that these are the easier forms of making defalcation in terms of inventory. Other opinions as found in the responses in this context are given as under:

1. Improper valuation of goods is done.
2. None of the errors or frauds is found in terms of inventory.
3. Valuation, issue and maintenance procedure with regard to stock is found to be defective.
4. In case of RGP where goods are sent outside factory premises and do not return back and are pending for a long time.

***Difficulty in Detection***

Errors are innocent or unintentional mistakes while frauds are intentional ones and are preplanned in such a manner that no one can detect them. Hence, it becomes very difficult to detect frauds in comparison of errors. The most common types of frauds or errors difficult to detect are fraudulent financial reporting, misappropriation of goods, embezzlement of cash and kickbacks. Views of respondents have been tested to determine the type of error or fraud that is most difficult to be detected in accordance with them. Table V.5 classifies the respondents on the basis of their opinions regarding the most difficult error or fraud to be detected.

**Table V.5**
**Difficulty in Detection**

| Errors or Frauds | Number of Respondents | Percent |
|---|---|---|
| 1. Fraudulent Financial Reporting | 73 | 44.24 |
| 2. Misappropriation of Goods | 32 | 19.39 |
| 3. Embezzlement of Cash | 26 | 15.76 |
| 4. Kickbacks | 51 | 30.91 |
| 5. Any Other | 1 | 0.61 |

The fraudulent financial reporting is most difficult to be detected from the point of view of more than two-fifths (44.24 percent) of the participants as per Table V.5. While, nearly, one-third (30.91 percent) of the participants are of the opinion that kickbacks are most difficult to detect. And approximately, one-fifth (19.39 percent) of the auditors participated consider misappropriation of goods to be most cumbersome to detect. Thus, no solid conclusion is arrived at but in accordance with more number of respondents, fraudulent financial reporting is most difficult to be detected. As accounts might already be manipulated with corresponding adjustments so that detection becomes very difficult. AAS 4 also recognizes fraudulent financial reporting and misappropriation of assets as the most common type of frauds. Another opinion as found in the responses is that errors and frauds committed by management are also most difficult to detect.

***Prevention and Detection of Errors and Frauds***

In accordance with AAS 2, ”Objective and Scope of Audit of Financial Statements”[2] issued by ICAI, the prime objective of an audit of financial statements is to express an expert opinion whether financial statements reflect true and fair view of financial position and operating results. It further states that the audit cannot insure that there are no frauds and errors in the audited financial statements. In fact, the objective of the audit is not to detect the fraud and error. Furthermore, as per AAS 4, the prime responsibility of prevention and detection of frauds and errors lies with management and not with the auditor. It is attempted in this section to determine the responsibility of an auditor with regard to prevention and detection of errors and frauds from the point of view of participant auditors with the help of a negative statement. Responses of participant auditors in this regard have been shown in Table V.6 as follows:

**Table V.6**
**Prevention and Detection of Errors and Frauds**

| Responses | Number of Respondents | Percent |
|---|---|---|
| 1. Strongly Agree | 12 | 7.27 |
| 2. Agree | 40 | 24.24 |
| 3. Undecided | 18 | 10.91 |
| 4. Disagree | 62 | 37.58 |
| 5. Strongly Disagree | 33 | 20.00 |
| Total | 165 | 100.00 |

[2] AAS 2 has been renamed and revised along with AAS 1 and both constitute SA 200 (Revised) “Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing”

It is suggested by Table V.6 that nearly three-fifths (57.57 percent) of the respondents either disagree or strongly disagree to the statement that prevention and detection of errors and frauds is not at all the responsibility of an auditor. In other words, they accept that auditors are responsible for prevention and detection of errors and frauds. On the contrary, nearly, one-third (31.51 percent) of the participant auditors in the analysis either confirm or strongly confirm that prevention and detection of errors and frauds is not at all the responsibility of an auditor. More than one-tenth (10.91 percent) of the respondents are indifferent in this regard. In accordance with most of the respondents, the auditor is responsible for prevention and detection of errors and frauds. It is because of the fact that auditors are held liable in numerous cases for misfeasance or failing in performing their duty well. As found in the responses, some of the auditors have substantiated their views as follows:

1. To some extent, it is the responsibility of the auditor to prevent and detect errors and frauds.
2. Although, he is not responsible but fraud should come out by audit reporting.
3. Auditor is only a watch dog.

***Prime Responsibility of Auditor***

AAS 4, “Auditor’s Responsibility to Consider Fraud and Error in an Audit of Financial Statements” states that prevention and detection of frauds and errors is the prime responsibility of management while the auditor is responsible to express an opinion on financial statements whether they are free from material misstatements, to assure that financial statements are properly stated in material respect by gathering evidence through audit procedures and to satisfy himself that frauds and errors having material impact have not occurred. Views of respondents have been examined to judge the prime responsibility of an auditor in this respect. Table V.7 categorizes the responses in terms of prime responsibility of an auditor as given below:

**Table V.7**
**Prime Responsibility of Auditor**

| Prime Responsibility | Number of Respondents | Percent |
|---|---|---|
| 1. To Express an Opinion on Financial Statements Whether They are Free from Material Misstatements | 130 | 78.79 |
| 2. To Assure that Financial Statements are Properly Stated in Material Respect by Gathering Evidences Through Audit Procedures | 34 | 20.61 |
| 3. To Satisfy that Frauds and Errors Having Material Impact have not Occurred | 10 | 6.06 |
| 4. Any Other | 4 | 2.42 |

It is shown by Table V.7 that in accordance with nearly, four-fifths (78.79 percent) of the participants, to express an opinion on financial statements whether they are free from material misstatements is the prime responsibility of an auditor. On the other hand, to assure that financial statements are properly stated in material respect by gathering evidences through audit procedures has also been stated as the main responsibility of an auditor by more than one-fifth (20.61 percent) of the respondents.

To express an opinion on financial statements whether they are free from material misstatements has been considered to be the prime responsibility of an auditor by most of the auditors participated in the study. It is because of the fact that as per AAS 2, “The Scope and Objective of Audit of Financial Statements”, expression of opinion on financial statements is the main objective of an auditor so that users can determine truth and fair view of financial statements. Other opinions as found in the responses in this respect are as follows:

1. In changing scenario, giving assurance to changing system functioning is vital.
2. Financial accounts represent true and fair view of the state of affairs of the company.
3. True and fair presentation of financial statements.
4. To give a true and fair view of the date of financial statements.

***Responsibility in Exceptional Case***

In accordance with AAS 4, “Auditor’s Responsibility to Consider Frauds and Errors in Audit of Financial Statements”, if no remedial action has been taken by the client even though he has been reported that fraud is persisting all round and integrity and competence of management is seriously suspected by the auditor, the legal, suitable and professional responsibility of an auditor can be reporting the person who made the audit appointment, reporting to regulatory authority, considering the possibility of withdrawing from audit engagement and considering the legal requirement of reporting to appointing or reporting authority. Attempt has been made to determine most legal, suitable and professional responsibility of an auditor in such an exceptional case from the point of view of respondents participated in the study. Table V.8 shows the responses of auditors on aforesaid matter as follows:

**Table V.8**
**Responsibility in Exceptional Case**

| Responsibility | Number of Respondents | Percent |
|---|---|---|
| 1. Reporting to the Person who made the Audit Appointment | 52 | 31.51 |
| 2. Reporting to Regulatory Authority | 28<br>26 | 16.97<br>15.76 |
| 3. Considering the Possibility of Withdrawing from Audit | 62 | 37.57 |
| 4. Considering Legal Requirement of Reporting to Regulatory or Appointing Authority | 8 | 4.85 |

| | | |
|---|---|---|
| 5. Any Other | | |

It is revealed by Table V.8 that nearly, two-fifths (37.57 percent) of the respondents would consider the legal requirement of reporting to regulatory or appointing authority first and then would like to take any step in aforesaid case. While, approximately, one-half (48.48 percent) of the participants would prefer to report to either appointing or regulatory authority directly. On the contrary, nearly, one-sixth (15.76 percent) of the auditors participated in the analysis can consider the possibility to withdraw from the audit engagement also. Thus, most of the respondents are in support of either considering legal requirement to report or straight forward report to appointing or regulatory authority but not to withdraw from audit engagement. It may be because of the fact that the previous auditor is required to give reasons for withdrawal to subsequent auditor and others. And it becomes his duty also to report to the appointing or regulatory authority. Other opinions obtained in this respect as found in the responses include:

1. It depends upon situations.
2. Differ from case to case.
3. Qualify audit report and copy it to all concerned authorities.
4. It should form part of audit report.
5. Qualify audit report and reasons to be given to successive auditor.

***Non-Compliance of Laws and Regulations***

Non-compliance refers to act of omission or commission by the entity being audited, either intentional or unintentional, which is contrary to prevailing laws or regulations as per AAS 21 [3], ”Consideration of Compliance of Laws and Regulations in an Audit of Financial Statements”. While carrying on a business, the entity has to comply with various rules,

[3] AAS 21 has been renamed and revised and has become SA 250 (Revised).

regulations and laws in course. On the other hand, an auditor is responsible to design audit procedures in such a way that audit procedures may reveal the conditions which lead to questioning the entity about compliance of laws and regulations. If non-compliance is discovered, he may report to management, authorities and users of financial statements as per requirement. But, if highest authorities are themselves involved in non-compliances, he can consider withdrawing from audit engagement. An attempt has been made to examine the views of participant auditors in case of highest authority is itself involved in non-compliance of laws and regulations whether they would like to withdraw from audit engagement rather than to continue. Table V.9 presents the responses of participant auditors in this relation as follows:

**Table V.9**
**Non-Compliance of Laws and Regulations**

| Responses | Number of Respondents | Percent |
|---|---|---|
| 1. Strongly Agree | 45 | 27.27 |
| 2. Agree | 60 | 36.37 |
| 3. Undecided | 30 | 18.18 |
| 4. Disagree | 22 | 13.33 |
| 5. Strongly Disagree | 8 | 4.85 |
| Total | 165 | 100.00 |

It is indicated by Table V.9 that nearly, two-thirds (63.64 percent) of the participant auditors would prefer to withdraw from the audit engagement rather than to continue in case it is concluded that highest authority is itself involved in non-compliance of laws and regulations. Even more than one-fourth (27.27 percent) of the respondents show their strong willingness to withdraw in such a case. On the contrary, nearly, one-fifth (18.18 percent) of the auditors participated in the study would like to continue. And exactly equal number of respondents, nearly one-fifth (18.18 percent) of the participants are in a state of indecisiveness in this regard.

Thus, majority of respondents would like to withdraw from audit engagement rather than to continue in case the highest authority is itself involved in non-compliances. It might be due to the reason that in spite of the independent status of the statutory auditor, he has to rely upon management and highest authorities in such matters where no other source of information is available. However, in accordance with one of the respondents, the auditor's responsibility is to report and express opinion on compliances or other matters, it does not matter who is involved.

To summarize the findings; misstatement with respect to opening balance is seldom found. However, more or less, all types of errors and frauds are prevailing but understatement and overstatement of accounting figures is more prevalent. In relation to payment of wages, inclusion of dummy names of workers is more found. On the other hand, respondents are indifferent in between misappropriation of goods and thefts or inventory loss in terms of stock. On the contrary, fraudulent financial reporting is most difficult to be detected.

Majority of respondents accept that auditors are responsible for prevention and detection of errors and frauds still expression of opinion on financial statements whether they are free from material misstatements is the prime responsibility of an auditor in accordance with most of the respondents. If no remedial action has been taken by the client even though he has been reported that fraud is persisting all round and integrity and competence of management is seriously suspected by the auditor, most of the respondents are in support of either considering legal requirement to report or straight forward report to appointing or regulatory authority but not to withdraw from audit engagement. But, majority of respondents would like to withdraw from audit engagement in case highest authority is itself involved in non-compliance of rules and regulations.

## Conclusion and Recommendations

Occurrence of errors and frauds in financial statements has become a universal problem. It can be concluded from the study that relatively all types of errors and frauds are prevailing especially understatement and overstatement of accounting figures and fraudulent financial reporting is most difficult to be detected. Auditors acknowledge their role in prevention and detection of errors and frauds but expression of opinion whether financial statements are free of material misstatements is their prime responsibility in accordance with them. Most of the auditors would like to withdraw from the audit engagement rather than to continue in case the highest authority is itself found to be involved.

Auditors will remain helpless until they are made independent of the enterprise, they are auditing in terms of both their appointment and remuneration. Also, there is no antidote available to change the mind sets of the people who are involved in unfair activities. Some operational suggestions that can be proved to be helpful in this context are mentioned as follows:

1. Sincere and quick actions are required on the part of authorities to make the auditors independent of the client i.e., neither client should be involved in his appointment and nor in payment of his remuneration directly. In spite of recognizing this fact long before, no concrete step has been taken until now in this context either nationally or internationally.
2. Internal check is the most powerful weapon to prevent errors and frauds at least at employee's level. Thereby, new and effective means of ensuring internal checks must be designed and implemented as well. Moreover, it must be made mandatory to observe internal checks in each and every transaction of the enterprise by the authorities.
3. Simplification of accounting procedures will also help in reduction of errors and frauds as it would become difficult for the client or its staff to find loopholes to avail undue benefit

and on the other hand, it would reduce the workload of the auditors enabling them to perform their duty more effectively.

4. Immediate steps to make internal audit strengthen in Indian enterprises are inevitable, i.e., making internal audit independent of management; identifying it as a distinct profession; compulsion of internal audit in defined size and type of organizations and other options can be given a serious thought and decisions can be taken accordingly.
5. Peer review should be made more effective by including some disciplinary mechanism in it.

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