Audit Procedures

What is Audit Procedures?

Audit Procedures are steps performed by auditors to get all the information regarding the quality of the financials provided by the company, which enable them to form an opinion on financial statement whether they reflect the true and fair view of organisation financial position. They are identified and applied at the planning stage of the audit after determining audit objective, scope, approach, and risk involved.

Audit Procedure Methods

During the process of the preliminary assessment, an auditor is required to identify and ascertain the amount of risk involved and accordingly develop an audit plan. The audit plans should define these steps, which will be applied by the auditor to obtain **audit evidence**.
They can be divided into two types:

#1 – Substantive Audit Procedures

Substantive procedures are processes, steps, tests performed by auditors, which creates conclusive evidence regarding accuracy, completeness, existence, disclosure, rights, or valuation of assets/ liability, books of accounts, or **financial statements**. For any procedure to be concluded, the auditor should collect enough audit evidence so that another competent auditor, when applies the same procedure on the same documents, makes the same conclusion. It can be regarded as complete checking. Auditor usually uses this procedure when he is of opinion audit area includes a high frequency of risk.

#2 – Analytical Audit Procedures

Analytical procedures can be defined as tests/ study/ evaluations of **financial information** through analysis of plausible relationships among both financial and non-financial data. In simple language, certain checks/tests conducted by auditors based on study/ knowledge/ previous year figures to check and form an opinion on financial statements. Depending on the audit area, the analytical audit procedure may differ. For example, the auditor may compare two sets of financial statements of the same entity about two different financial years or sometimes may compare two separate entities' financial data for obtaining audit evidence.

Types of Audit Procedures

- **Inspection –** Inspection is the most commonly used method. Under this, the auditor checks every transaction/ document against written steps, procedures to ensure accuracy.
- **Observation –** Under this technique of audit, the auditor usually tries to inspect others doing/ performing a particular process. E.g., An auditor may observe steps followed in processing **GRN (gods received note)** against goods purchased.
- **Confirmation –** This type is applied to ensure the correctness of financial statements either from internal sources within the auditee organization or from external sources.
- **Recalculation –** Under this audit method, **the auditor** usually crosses the checks information presented by the client. It is generally used in case of checking mathematical accuracy.
- **Reperformance –** Using this procedure, the auditor re-perform the entire process is performed by the client to find out gaps, audit findings, etc.

Practical Examples of Audit Procedures

- The auditor may evaluate outstanding customer balance by preparing debtors' aging schedules etc. The auditor may compare the same for two different audit periods and find conclusions based on thereon. Like if there is no change in credit policy, no significant change in sales, **debtors** balance should almost be the same, etc.
- Ratio analysis: The auditor may use this method as while checking the working capital auditor may compare the current ratio of the different **reporting period**. This comparison of current assets/current liabilities should be almost the same unless the organization amended its policies related to any of the working capital items.
- The auditor may check and compare the employee benefits **expense accounts** for the different accounting periods. This amount should be the same or rise following promotion/ incremental policies. If an auditor finds a different reason for rising/ decline other than due to policies or employee turnover, there are chances of fraudulent payments being processed to fake employees through the payroll system.
- Cross-checking any expenses in line with the quantity and rate and matching with actual figures. For example, suppose 5KGs of potatoes of $25/Kg results in 1 KG of potato chips. The auditor should check actual expenditure should be around $25 for producing 1 KG of potato chips.
- Examine a trend line of any expenses. This amount should vary in accordance with production. If not matching, there are chances that management may not be correctly recognizing expenses promptly.

Advantages

Some advantages are as follows:

- It helps an auditor to obtain conclusive and substantial audit evidence for forming an opinion on financial statements.
- Well defined procedures define the quantum of time and energy, which needs to be deployed for finding audit evidence.
- Pre-established procedures help an auditor to follow a defined set of steps that need to be followed for finding audit evidence.
- They also help and auditor to plan areas that need to be focussed and deciding the type of audit procedure that needs to be applied well.

Limitations

Despite several audit procedures applied by an auditor, he/she cannot conclude whether financial statements prepared presents a true and correct view. An auditor expresses an opinion which is always subjected to inherent limitations of an audit, which are described as follows:

- **Human Error:** Despite checking at a thorough level, there are chances of being expressed an inadequate opinion due to human errors and omissions. Since there is always a person present behind any machine.
- **Absence of Clear Instructions in Accounting:** Auditing standards do prescribe series of steps to be followed while conducting an audit, but there are situations that are still undefined. Treatment needs presumptions in these cases.
- **Existence of Management Fraud:** There may be chances of fraud committed at high-level management or by collusion of

the group of employees. Since auditor forms an opinion based on data shared by the auditee, the auditee may not be in a position to detect such fraud.

- **Judgements:** In preparing financial statement, there are situations where management needs to make a judgement which may differ from one to another. With this change in judgements, an auditor may not depict the exact position of that business.

Important Points

With the change in the business environment, business models, the auditor needs to ensure changes in predefined audit procedures. Since with the change in environment, these procedures also become obsolete. For example, with the increased automation, an auditor needs to implement audit procedures keeping in mind the computerized environment involved. An audit without a system audit may be incomplete and may result in forming the wrong audit opinion.

Conclusion

Audit Procedures are a series of steps/processes/ methods applied by an auditor for obtaining sufficient audit evidence for forming an opinion on financial statements, whether they reflect the true and fair view of the organization's financial position. It is mainly of two types – substantive and analytical procedures. Depending on risk assessment, auditor applies audit procedures. These help an auditor to plan audit and accordingly invest time for obtaining audit evidence. Audit opinion, still, is subjected to inherent limitations of an audit.