"Audit Proceedures"

Definition / Meaning:

They are the processes, techniques, and methods that auditors perform to obtain audit evidence, enabling them to conclude the set audit objective and express their opinion. They are also known as Audit Programmes.

Auditors normally prepare audit proceedures at the planning stage. Once they are identified audit objectives, audit scope, audit approach & audit risks follow.

Auditors design audit proceedures to detect all kinds of risks that are identified and ensure that the required audit evidence is obtained sufficiently and appropriately. Normally audit partners (clients) need to approve audit plans & audit proceedures before the audit team performs their testing. This is to make sure that all concerns or risks are addressed in the proceedures.

Audit proceedures are different from client to client and period to period. This is because internal control over financial reporting is different from one client to another, and the control might be changed from time to time. The auditor might need to update audit proceedures from time to time even though its team had audited current financial statements.

Audit Proceedures: There are proceedures that auditors use while undertaking audit work. They are as follows:

- Analytical Proceedures:

These proceedures include different processes through which auditors can analyse the financial statements of a company. These tools generally include analysis of trends, ratios or relationships between the information in the financial statements. It can also include determining the ratio relationship between financial & non financial data.

Through analytical proceedures auditors can find inconsistencies in the

financial information presented in the financial statements of the company. Once they identify these inconsistencies auditors can investigate further, which includes discussing them with the management. If auditors can't obtain a satisfactory answer to justify the inconsistencies they can apply other procedures to confirm the differences.

- Confirmations :

Confirmations are documents sent by auditors to external parties to confirm their balances with the client. In confirmations the auditor directly contacts parties with whom the business has balances remaining. These may include banks, customers & clients.

- Inquiry :

In an audit inquiry refers to the process of asking clients for an explanation regarding anything. Under audit process auditors have the right to ~~to~~ seek information that is relevant to the preparation of financial statements or the purpose of conducting audit.

- Inspecting Records or Documents :

It consists of examining the supporting evidences for preparation of financial statements. Usually auditors check each document manually to check for its details. This process is termed as vouching and is an important part of the Test of Controls & Test of Details company performed by Auditors. Similarly, inspecting records may include tracing supporting documents from individual transactions & vice versa. Sometimes auditors can also inspect non financial documents to confirm other aspects of financial statements. For example : auditors may inspect Sales/Purchase System to determine whether details of debtors/creditors match with accounting system.

- Inspecting Assets :

This modus operandi works only for tangible fixed assets such as property

plant & equipment of the company. It can also include inspecting the company's inventory. This process helps to determine the state of affairs of fixed assets. Here auditors make a list of fixed assets & physically inspect them for existence.

- Observation :

Here auditors observe the processes and procedures performed by the client. Auditor through observation get an idea of how the processes & procedures of the client work & thereby identify any weaknesses within these procedures. Observation plays a crucial role at the end of year valuations of the company. At the close of the year companies count their inventory & cash to consolidate or update their records. Auditors can ensure their presence during these counts to obtain evidence of whether these processes take place effectively. These one off observations provide the best evidence for cash & inventory balances of the company.

- Recalculation :

Auditors recalculate the balances or transactions that the client has already carried out to ensure that the amounts in the financial statements match the auditors expectations what they should be? Auditors can identify differences between the expected amount & the actual amount & investigate it further. They can use recalculation to test the valuation & allocation, accuracy & assertions. For instance the auditors can recalculate the interest expense of the company & match it with the interest on loan depicted in the profit & loss A/c or financial statement.

- Reperformance :

In reperformance auditors independently perform the control procedures that the client has already done as a part of its internal control system. It is a useful part of its internal control system in the audit process. It may involve some calculations that are a part of client's internal control like bank reconciliation statements prepared by client.

"Vouching"

Meaning:
An Auditor judges the authenticity of the entries using the technique of vouching. Infact auditing is incomplete without vouching.
"The process of selecting a sample of transactions and then going through all the documentary evidence (vouchers) to ascertain the truthfulness of business related transactions is termed as vouching."

In auditing process, based on evidence (vouchers) the two main functions are:

- Collection of evidences - through observation, confirmation, inspection, inquiry.
- Evaluation of evidences - with relevance, adequacy and validity.

Objectives of Vouching:

→ To check whether all the business transactions are properly recorded in the books of accounts or not.
→ To see that recorded transactions are duly supported by vouchers (or not)
→ To verify that all the documentary evidence is authenticated & related to business transactions only.
→ To verify that transactions are free from errors & frauds.
→ To verify whether voucher is processed through all the stages of internal check system properly.
→ To verify & confirm that the entries are recorded ~~through~~ according to the capital and revenue nature or not.
→ To check the accuracy of accounting transactions.

Importance of Vouching:

Vouching is an important part of auditor's duty. In case of negligiance in vouching the Auditor will be held responsible & he cannot escape from his duty if he has done vouching carelessly. Its importance can be viewed from the following:

→ Vouching is as important as passing of original entry in the books of accounts. If original entry is wrong it will affect every process of accounting entry & its impact will be on the end result. Wrong entry must be traced & rectified in the bud.

→ Efficiency of vouching decides the success of audit.

→ Any errors & frauds are easily detectable if vouching is conducted in searching and intelligent manner.

→ Intelligent & faithful vouching establishes reliability on financial statements of the organisation, & then they present a true & fair picture of the business.

→ It is complementary to & aids to internal control system, auditor then can resort to test checking rather than comprehive vouching.

Transactions	Vouchers to be examined
Sales	Sales order, sales invoice, goods outward register, cash receipt bank pay-in-slip etc.
Purchase	Quotations, purchase orders, purchase bills good inward register etc.
Cash payments	Demand note, cash receipt, cash memo etc
Cash received	Duplicate or carbon copy of cash receipts, contracts & correspondence with payee etc.
Payments received through Bank	Bank deposit slip, cheque received, bank statements etc.

Important points to be considered while vouching :-

- Accuracy of transactions
- Authenticity of transactions
- Proper classification of accounts
- Vouchers should be properly & serially numbered & arranged accordingly.
- Every checked voucher should be tick marked with sign.
- Amount of receipt should be same in words & in figures.
- Every bills must be accompanied by a receipt & period of payment be on the receipt
- Receipt must clearly indicate 'advance payment' if it is so.

- Voucher should be issued in the name of designation & not any personal name.
- Proper certification of vouchers should be there by any responsible officer of the company.
- Investigation about any missing vouchers should be made comprehensively.
- Every alteration in voucher must be authenticated by concerned officer.
- Vouching should be completed in one sitting for a particular period of time.
- All expenses should be examined by the Auditor.
- Cash purchases should not be recorded twice one as cash purchase & other one as credit purchase.
- Every payment voucher of above Rs 5000 should bear a revenue stamp.
- Cash receipts should only be upto a maximum of Rs 20000/-

"Verification of Assets & Liabilities"

Meaning:

Verification of Assets & Liabilities means the inspection of assets appearing in financial statements, whether the assets are according to legislation or not. It is undertaken by the Auditor to confirm the following:

- → Existence
- → Ownership
- → Proper Valuation
- → Possession
- → Freedom from encumbrances
- → Existence in records.

Objectives of Verification:

- Confirmation about the existence of assets through physical verification.
- Legal & 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.

Vouching & Verification compared:

→ Vouching relates to confirmation of the correctness & authenticity of accounting entries as they appear in the books of accounts while Verification confirms their existence, ownership & valuation as they exist in the Balance sheet.

→ Vouching relates to documentary evidence & verification to observation & documentary evidence both.

→ Vouching examines correctness, validity & completeness of the transactions & Verification confirms ownership, possession, existence valuation & disclosure of the items appearing in the Balance sheet.

Verification of Certain Assets & Liabilities :-

→ Copyright :-

Copyright provides legal protection and legal rights to an author by which the publication of his work by another is prohibited. Copyright remains with the author for life time and even 50 years after his death.

Verification of Copyright :-

→ The auditor should examine the agreement between the author & the publisher.

→ If there are number of copyrights with the same publisher, auditor should ask for the Schedule of copyright.

Valuation of Copyright :

Copyrights lose their value over a passage of time hence its value is not stable. In case where the sale of publication is very less or nil the value should be written off. In Balance Sheet it would be shown as cost less the value written off.

→ Verification & Valuation of fixed asset

(a) Land & Building:

- Auditor should examine the title deed of the land & building.
- Land & Building shown in the books should be according to the title deed.
- Profit or loss on sale of it should be duly adjusted in the account.
- Any addition to it should be carefully examined by the Auditor.

→ Verification of Mortgage Property :

- The Auditor should confirm that there should be no second or third mortgage on it.
- The Auditor should obtain certificate from mortgagee that title deed is in his possession.
- The Auditor cannot be held responsible if there is any defect of title. He can only verify title deed as apparently in order & in the name of client.
- If Auditor feels necessary he can obtain certificate from legal advisor about the validity of title deed of the client.

Valuation of Building:

→ Building should be valued at cost less depreciation

→ If the market value of building is higher than the cost still depreciation should be provided

→ Depreciation would be provided even if building is not in use

→ Market resaleable value should not be considered as it is fluctuating.

Valuation of freehold land :-

→ Freehold land is shown at cost as it is not depreciable

→ Cost includes legal charges, registration fees, purchase price & broker commission etc

→ Payment made as development charges to Local Body is included in the cost.

→ If the basis of valuation of it is market value or realizable value; it must be clearly mentioned in the balance sheet.

Verification of Building under construction :

→ Auditor should verify the architect certificate & contractor receipt for amount paid.

→ Auditor should obtain a certificate from a responsible officer to that effect, if the staff of client is also engaged in its construction.

Verification of Leasehold Property :

There should be seperate accounting for freehold & leasehold property. Leasehold property is acquired for fix duration on lease. The Auditor should consider:

→ Inspection of lease agreement for value & duration.

→ Lease agreement should be registered with the ~~registrar~~ registrar.

→ Terms & Condition of the lease are properly complied with.

→ Auditor should examine the last receipt of land to ensure the lease agreement is in continuation without any break due to non payment of rent

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Verification & valuation of current Assets :-

Cash in hand :-

→ It is verified by actual counting of cash at the close of business on the date of balance sheet. Counting of cash must be done in the presence of cashier. If physical verification of cash is not possible Auditor should ask the Cashier to deposit all his cash in hand in the Bank Account on the last date & obtain counter foil of the receipt for the same amount.

→ Verification of cash in hand is primary duty of the Auditor & in case of non-verification Auditor shall be held responsible for breach of his duty. If there is the duty of accountant to make payment to employees & others, the Auditor should carefully verify the same.

Cash at Bank :

→ The Auditor should prepare a bank reconciliation account as on date. With the help of it, the Auditor will clearly come to know the status about the cheque issued but not yet presented in the bank & cheques deposited in the Bank but not yet cleared etc. It checks many kinds of frauds possible.

→ The Auditor should obtain different certificates from Banks for different types of accounts like current account, time deposit account, savings account overdraft account or cash credit Account etc.

→ The Auditor should obtain a letter of confirmation of Bank balances directly from the Banks.

→ The Auditor should compare the Bank balance as per Bank Book & the passbook.

→ If payments are deposited in foreign Banks under exchange control regulation it should be verified by the Auditor.

Sundry Debtors : Auditors ensure that :-

→ All amounts are recorded in respect of outstanding debtors as at date of B/S

→ Valuation of debtors is appropriate & properly applied.

→ That All debtors are disclosed, classified & described in accordance with recognized accounting policies & practices.

The verification process of the debtors involves the following :-

Examination of Records :

→ Auditor should satisfy himself about the validity, accuracy & recoverability of debtors balance

→ Excessive discount allowed or bad debts written off should be verified.

Direct Confirmation Procedure :

→ Direct Communication with debtors is the best way to ascertain whether the balances are accurate, genuine & undisputed.

→ Debtors from whom confirmation of balances is required, the method of requesting confirmation is to be determined by the Auditor.

→ Confirmation procedure may be carried out within a reasonable period from the end of the year.

→ Replies received from debtors should be carefully gone through & in case where balances donot agree, client should be asked to investigate.

→ The Auditor must pay special attention to those balances for which Confirmation is not received. They might be fictitious or made to conceal a fraud

Steps for Verification :

→ The book debts can be verified by the books of accounts & those should be supported by sale documents.

→ Book balances should be sent to debtors for confirmation. It would establish the existence of book debts.

→ Ownership of book debts can be verified with sales documents & sales ledger.

→ Debtors should enquire about any type of dispute with customers about discount, claim etc.

Steps for valuation :

→ Debtor's ledger should be supported by Sales ledger

→ Auditor should obtain list of bad debts, bad debts etc written off & the provision for doubtful debts.

→ Sundry debtors should be valued at realizable value.

→ If there is confirmation of balances it means valuation of debtors is correct

Verification & Valuation of Fictitious Assets :

Preliminary Expenses :

These expenses are incurred at the time of formation & commencement of Company. These expenses are of capital nature & include stamp duties, registration fees, cost of printing, legal costs etc. They appear in the Balance Sheet & have got to be written off during a span of 3 to 10 years.
The Auditor should verify that unwritten amount is shown in the B/S

Trade Creditors : Steps involved :

→ Auditor should collect Schedule of creditors & that should tally with ledger balances.
→ Purchase ledger should be checked & verified with purchase register, purchase invoices & debit notes etc.
→ Auditor shall verify the discount received or receivable from creditors
→ Auditors should minutely check the purchase of first month & last month of the year to avoid any possibility of booking purchases of current year to next year or last year purchase to current financial year.
→ Auditor should pay special attention on unpaid amount standing in ledger of Creditor since along time as there is a possibility that the amount has been misappropriated by an official & balance stands in books of accounts
→ Confirmation of balances should be done directly by Auditor
→ Hire purchase agreement to verify purchases made under Hire Purchase System shall be carefully studied by Auditor.

Verification & Valuation of goodwill :

Audit of goodwill at acquisition is not only to verify whether goodwill actually exists as a genuine asset but also to evaluate whether it is properly measured at an appropriate value in accordance with accepted accounting standards

Audit procedures for goodwill at the acquisition includes.

→ Inspect purchase agreement to ensure consideration paid & purchase date are correct

→ the fair value of net identifiable assets (goodwill) is prepared by the independent external party & ~~the~~ report has been submitted by it.

→ Obtain Board minutes & review for the discussion about the purchase of the Subsidiary Company.

→ Recalculation goodwill and compare with the goodwill recorded by the client

→ Ensure that the payment has been made by verifying with the Bank Statement & other related supporting documents.

"Investigation"

Meaning: It is an examination of accounts & records of a business concern with some special purpose in view. In majority cases the purpose of such an enquiry is to know the actual financial position of the concern so that an opinion can be formed and action taken accordingly. It is a sort of special audit & a scrutiny of accounts pertaining to several years for which investigation is to be conducted.

In the words of Taylor & Perry, "Investigation involves inquiry into facts behind the books and accounts, into the technical, financial & economic position of the business or organisation."

Objectives: It is conducted under following circumstances:

→ When a person intends to purchase a business.
→ When a new company wishes to purchase a ~~new~~ running company, business or firm.
→ When a person desires to enter into a partnership firm as a new partner.
→ When a person wishes to lend money to a business & wants to know its solvency.
→ When a person seeks avenues of investments.
→ When a person wishes to make a valuation of shares of the limited company.
→ When the proprietor of a business suspects a fraud.
→ When owners of the company suspect that the affairs of the company are not being properly managed (i.e. statutory investigation)

Essentials for investigation :- especially during the course of investigation

- Auditor must keep himself free from the influence of Directors & Managers
- Auditor should familarise himself with all the important details about the business before the commencement of his work.
- Auditor should seek the assistance of technical experts during the course of enquiry.
- Auditor should keep the purpose, process & outcomes of investigation a secret from employees of the company & organisation.

Scope of investigation : It depends upon the circumstances of the case whether its scope shall be extensive or limited to a particular issue.

→ The enquiry under investigation may go beyond the books of ~~accounts~~ accounts of the business concern.

→ It may cover matters of technical or financial nature.

→ It covers actual facts that need to be analyzed pertaining to the concern.

→ When investigator is appointed by the client the scope of activity should be obtained by him from the client in writing so that scope & nature of his duties are defined.

Process of Investigation :

There is no set procedure however it requires following steps in order of sequence :

→ Determination of objectives & establishment of scope of investigation :
At the stage of acceptance of the assignment the investigator should be absolutely clear about what is sought to be achieved by the investigation. The investigator must discuss the scope of investigation & in writing seek instructions on what is to to be achieved through the investigation.

→ Determination of time span of Investigation :
The period for which investigation is to be covered must be determined at the very outset, as it depends on the purpose of investigation.

→ Formulation of the Investigation Programme : The investigation programme should be drawn up having regard to the nature of business, instructions from the client embodying the objectives, the consequent scope & depth and the necessity to extend the investigation into books & records belonging to the others. The programme should also be flexible so that knowledge gained with the progress of work can be used to extend, reduce or modify the extent and areas of checking.

An effort in investigating programming should be devoted to localise the enquiry into the relevant areas, the initial wider base of enquiry should

be gradually narrowed & fixed at a level that is meaningful. Irrelevant matters not concerning the subject should be eliminated, so that this procedure alone will enable an indepth examination of matters relevant to the investigation.

→ Collection of evidence :

Through examination process the investigator gathers relevant evidence connected with matters to be investigated. In the course of examination of the documents & records, the Investigator may require to obtain oral explanations from various personnel of the concerned business. The Investigator should look for the most convincing evidence ; he should seek & examine all the available & should endeavour to reach at the truth of the matter. Finally he should seek the help of concerned experts' opinion in technical matters.

→ Analysis & Interpretation of Findings :

Careful analysis and correlation of facts & figures is necessary before the investigator reaches his conclusion. The conclusion should be well reasoned & backed by established facts & data. While interpreting the figures the Investigator must keep in mind various factors like political, economic, ~~competitio~~ competition faced by business, historical pattern of the data, nature of the business etc.

→ Report on the Findings :

Finally the Investigator submits his report on his findings to the client. The nature of the report is governed by two factors :-

First, the Instructions given by the client as regards the special aspects of the business which are required to be investigated and,

Secondly the findings of the investigating accountant :

"Auditing & Investigation compared"

Basis of Comparision	Auditing	Investigation.
1 Meaning :-	It is the process of inspecting the books of accounts of an entity & reporting on it	It's an enquiry conducted for establishing a specific fact or truth.
2. Nature	General Examination	Critical & indepth examination
3 Evidences	Evidences are persuasive in nature	Evidences are unquestionable & hence decisive in nature.
4. Time Horizon	Annually	As per requirement.
5. Performed by	Chartered Accountant	Experts.
6. Reporting	General Purpose	Confidential.
7. Obligatory	Yes	No.
8. Appointment	Appointed by Shareholders of the Company.	Management or Shareholders or any third party can appoint him
9. Scope	Seeks to form an opinion on financial statement.	Seeks to answer the questions that are asked in the engagement letter.
10. Statutory Requirement	Public companies ~~not~~ need to get their accounts audited annually	No provisions exist.

"Divisible Profits of a Company & Dividend"

Meaning of Divisible Profits:

Divisible Profits of a company mean "profits available for recommendation and distribution as dividends after setting aside amounts for reserves or carrying forward as the Directors deem fit. Directors can carry forward entire profits for the year if they deem it necessary.

Profits imply excess of incomes over costs. Profits can be revenue profits or capital profits. Every profit cannot be considered as divisible profit. The available profit should be such that is legally distributable in accordance with the provisions contained in:

(a) The Companies Act 1956
(b) The Income Tax Act 1961 &
(c) The articles of Association of the Company.

Profits arising on revaluation or sale of assets or on reissue of forfeited shares under normal circumstances cannot be considered a part of divisible profits. But it is distributable on the conditions that:

(a) Such distribution is authorised by Articles of Association
(b) Such surplus is actually realised in cash or remains after a proper valuation of all assets, and
(c) The capital losses are covered

Dividends payable:

Out of Divisible Profits with reference to:

(A) Company's Act 1956 Section 205:

This section provides for certain conditions that must be fulfilled before the profits are distributed as dividends:

→ Out of profits of the company for that year after providing for depreciation
→ Out of profits of the company for any previous financial year or years arrived at, after providing for depreciation
→ Out of both or
→ Out of moneys provided by Central Govt. for payment of dividends in pursuance of a guarantee given by the Government.

(b) If the Company has not provided for depreciation for any previous year or years, it should provide for such depreciation out of profits for that year or years before declaring or paying dividend.

(c) If the company has incurred any loss in any financial year or years, then the amount of loss or an amount equal to the amount provided for depreciation for the year or years whichever is less should be set off against the profits of the company for the year for which dividend is proposed to be declared or paid or against the profits of the company for the any previous financial years or years, arrived at in both cases after depreciation as per section 205(2) or against both.

(d) The Central Government may in public interest allow any company to declare or pay dividend for any financial year without providing for depreciation.

The Companies Act 1974 ~~enjoys~~ enjoins a provision that a company should provide reserve not exceeding 10% of its profits before the dividends are declared.

(B) Income Tax Act:

Section 109 of this Act provides for declaration of a statutory percentage of distributable income as under in respect of the following classes of companies.

→ 45% in the case of consultancy service company

→ 90% in the case of an investment company

→ 60% in the case of other companies.

It also states that the company must have to pay additional income tax if statutory distribution is not made.

Auditor while conducting audit in respect of divisible profit & declaration of dividend must ensure:-

(a) That while examining extent of divisible profit all provisions related to divisible profits have been followed.

(b) Dividends have been declared as per provisions of the Act-

→ Companies Act with amendments

→ Income Tax Act

→ Legal Decisions on the issue

→ Central Govt. rules & directions

"Internal Audit"

Meaning:

Internal Audits evaluate a company's internal controls including its corporate governance & accounting processes. These audits ensure compliance with laws & regulations and help to maintain accurate & timely financial reporting and data.

Objective:

To provide independent assurance that an organisation's risk management, governance and internal control processes are operating effectively

Types:

Compliance audits: adherance to policies, plans, procedures, laws, regulations, contracts
Operational audits: focuses on controls of key processes, procedures or systems
Financial audits: evaluation of financial statements
Information technology audits: Management controls within IT applications, operating systems, databases or the infrastructure.

Performance of Internal Audit: Steps involved:

(i) Know what & when to audit
(ii) Create an audit schedule
(iii) Preplanning the scheduled audit
(iv) Conducting the audit
(v) Record the findings
(vi) Report the findings.

Advantages of Internal Audit

→ More effective management as staff is kept on its toes
→ On going review is possible & corrections can be made at right time
→ performance of staff improve as they are always on their guards
→ Ensures Optimum use of Resources
→ Division of work between work & observation.

Disadvantages

→ Shortage of Qualified staff
→ Ignorance of management
→ Auditing delays accounting process.
→ Wastage of time
→ Expensive process together with external audit

Internal & External Audit, compared :

Internal Audit	External Audit
① It is conducted by the Employees of the Company	① It is conducted by employees of outside audit firm.
② Hired by the company	② Appointed by shareholders vote.
③ They are not necessarily CA's	③ Only CA's can conduct it
④ They are responsible to Management	④ They are responsible to shareholders
⑤ Findings are issued in report format	⑤ They use specific formats for audit opinions
⑥ They can provide advice & assistance to employees	⑥ The advice & assistance to employees cannot be provided by them.
⑦ The audit is conducted throughout the year	⑦ These audits are generally held annually.
⑧ It examines issues related to Company business, practices & risks	⑧ Auditors examine financial records & issue an opinion regarding financial statements of the company.