

Audit - II

Audit procedure and Documentation

Audit planning :

An audit planning permeates audit performance, and vice versa. An Auditor plans and performs and as he performs modify his plan to make his planning conform to the situations of exigencies that emerge, Therefore, an audit planning is a continuous exercise.

It comprises of two dimensions

a) Developing an overall audit plan - guiding the matters of audit objectives, Scope, time, framework, reporting requirements.

b) Developing an audit programme showing the nature, timing and extents of audit procedure.

Benefits :

Appropriate attention to important areas.

potential problems promptly identified.

Time bound progress and completion

coordination of work of auditor and experts.

Factors affecting audit planning:

- 1) The term of engagement
- 2) Statutory duties connected with audit
- 3) The nature of reports, timing for submission.
- 4) Legal and statutory ~~requirements~~
- 5) Accounting policies followed by the entity, any change effected there on.
- 6) The effect of new accounting or auditing pronouncements by the governing body.
- 7) Identification of materiality level for audit purpose.
- 8) Identification of significant and special audit areas.

Audit programming:

The audit programme would be developed satisfying optimally the constraints of time and cost without in any way compromising the quality of audit.

It is an plan of action translated into specific ~~work~~ of audit work with check list of actions to be performed.

Audit programme entails the following:

1. Specific listing of audit area components in

2. Staff positioning
3. Timing built in
4. Sequencing
5. Responsibility fixing
6. Documentation.

Advantages :

1. The audit programme acts as a guide and ensures all areas have been duly attended to without any omission.

2) The progress of work can be assessed.

3) provides minimum insights for checking the future audit planning for the years to come.

4) It documents the stage of work at any point of time.

5) Duties of persons who should perform it can be identified.

6) Effective communication of direction.

7) Details of audit staff employed.

8) final view of work performed can be easily identified.

9) Identifies the place of hazardous audit play.

10) The record of training of the audited clerks with the auditor can easily be compiled for the audit programme.

Procedure :

1) Planning the Audit :

Understand the client's business and industry.

Identify the scope and objectives of the audit.

Assess risk and internal control
allocate audit work among the members.

2) preparing the audit programme :

create a plan of audit procedures for each area.

Include nature, timing and extent of audit tests.

customize for the specific client and risk identified.

3) conducting field work :

perform substantive and control tests

collect and evaluate evidence

verify asset and

observe internal control system in action.

4) Documentation :

Record all findings and evidence

Note any irregularities or deviations from standard practices

Maintain working paper as proof of audit work done.

5) Review and Supervision:

Senior auditor or managers review work done by juniors.

Ensure compliance with auditing standard ~~practices~~ programme

~~explain~~ Address any unresolved issues or errors.

6) Reporting:

prepare the draft audit report

Discuss findings with management

finalize and issue the audit report with opinion.

Contents of audit programme:

1. Name of the company
2. Nature of operations of the company
3. A review of the system of internal check.
4. Date of commencement of audit
5. Tentative period of audit exercise.
6. Accounting system followed by the company
7. preparation of the audit report.
8. Instructions mentioned by previous year auditor.
9. Schedule of checking of various subsidiary.
10. Schedule of checking of ledger accounts.

Internal audit :

Internal audit is the verification of operations within business by a specially assigned team

It is an independent, objectives assurance and consulting activity, designed to add value and improve an organisation's operations.

Role of Internal Audit :

1) Reliability and integrity of information.

2) Compliance with policies, plans, procedures laws and regulation.

3) Safeguarding assets.

4) Economical and efficient use of resources.

5) Accomplishment of established objectives and goals for operations or programme.

Objectives :

1) Reviewing of operations and transaction as a service to management.

2) Facilitating final audit

3) Ensuring systematic accounting and proper recording of transactions.

4) Reducing the possibility for manipulation of accounts or misuse of property of the business.

5) ~~Highlighting~~ Highlighting the weak areas of the organisation and giving suggestion to strengthen them.

Types of Internal Audit :

- 1) Financial Audit
- 2) Operational Audit
- 3) Management Audit
- 4) Compliance Audit
- 5) Systems Audit
- 6) Information System Audit
- 7) Investigation Audit.

Procedure of Internal Audit :

1) Establish and communicate the scope and objectives for the audit to appropriate management.

2) Develop an understanding of the business area under review.

3) Describe the key risks facing the business activities within the scope of the audit.

4. Identify control procedures and to ensure each key risk and transaction type is properly controlled and monitored.

5) Develop and execute a risk based sampling and testing approach to determine whether the most important controls are operating as intended.

6) Report problem identified and negotiate action plans with management to address the problem.

7) Follow-up on reported findings at appropriate intervals.

Internal control:

Internal control system implies the whole system of Superintendence employed internally by the management of a legal entity to carry on its business in an orderly and efficient manner.

It broadly contains internal checks, internal audit and other devices of control.

Objectives:

1) Providing reasonable assurance on records are valid, complete and accurate.

2) Recorded transaction are duly authorised.

3) Transaction are properly classified and valued.

4) Transaction are recorded at proper time.

5) Transaction are properly posted to the ledger accounts, and correctly summarised.

From of Internal control:

Accounting control

Budgeting control

Standard costing and deviation analysis

Internal check

Internal audit

Bank reconciliation

Self Balancing ledger

Administration control

Time studies

Motion studies

Quality control

Performance

Appraisal

Statistical

Analysis

Principles of Good Internal control:

A well designed accounting system should be in operation.

Responsibility for the performance of the job must be clearly stated.

Too much confidence should not be pinned in one individual.

Rotation principle stating to transfer of an employee from one job to another should be the inflexible guiding Rule.

Mechanisation of work wherever possible.

The work should be so arranged that work done by one employee should be promptly checked by another employee.

Arrangement of work should be in written record of the role played by each employee.

Clear & well defined rules should be laid down.

Employee must be in bond.

Although not a substitute for perceptive financial internal control.

Internal check:

Internal check refers to such an arrangement of bookkeeping routine that error and fraud can be prevented or discovered by the very operation of the bookkeeping itself.

It is something inherent in the accounting system and differs from internal audit because latter is applied after entries are completed, whereas, internal check operates at the moment when they are made.

Objectives:

To prevent or minimize the chance of error, frauds or any sort of irregularity.

To discover error & fraud if any.

To ensure the accuracy and credibility of records of business transaction.

To facilitate early finalization of final accounts.

Essentials of Good internal check system:

cash received should be deposited in bank daily.

All payments other than petty cash payments to be made by cheque, whatever the amount may be.

The petty cashbook to be kept upon the imprest system under the supervision of the cashier.

Proper counterfoil or duplicate receipts books to be used for all moneys received.

cash and bank balance to be verified frequently.

cash ledger to be rendered self-financing.

An adequate system of stock accounts and cost accounts to be provided.

All invoices for purchase to be passed by the goods received department by the buyer department concerned.

Statements for trade payments to be passed by some responsible person.

Calculations of all sales invoices to be checked.

A definite system to be set up for dealing with the collection of overdue books.

computerised system of wages to be introduced

Duties of members should be varied from time to time.

Every member of staff should take a holiday at least once a year.

No member of the staff should be allowed to perform duties of another.

Employees having the control or collection of cash to be required to take out guarantee insurance policy.

Procedure of Internal check:

Small concerns:

Correspondence

Remittances & deposits

payment authorisation

wages & salaries

Goods

Manufacturing concerns:

Access to ledgers

Correspondence

Remittances

Deposits

printed form

cash sales

payment authorisations

wages

petty cash

purchase

credit notes

Statement of accounts

control accounts

mechanical appliances

Stock and stores

Cash Receipts:

- Receipt books
- Acknowledgement
- Remittances received
- Deposits
- Receiving and sending
- Physical count

Segregation

Cash payments:

- Mode of payment
- Authorization
- Recording
- Vouchers
- Circular

Petty cash transaction

- Imprest
- payments
- Allocation
- Reimbursement
- Cash count
- Miscellaneous receipts

Purchases

- Initiation of purchase
- Quotations and tenders
- Placing orders
- Cashier's received
- Cash book
- Mechanical device

Stores:

- Ordering level
- Placing order
- Receipt of material
- Storing of material
- Records of material

- Payment of Material
- Issue of Material
- Return of Material
- Charging for material
- Periodical checking of Material

Vouching :

Vouching is a technical term, which refers to the inspection by the auditor of documentary evidence supporting and substantiating a transaction.

- Ronald A. Irish.

Objectives of vouching :

- 1) To examine the accounting entries recorded in the books of account with reference to documentary evidence in support thereof.
- 2) To judge the accuracy, adequacy and credibility of such documentary evidence.
- 3) To examine the authenticity of the transaction recorded.
- 4) To ensure that no transaction remains unrecorded in the book of accounts.

Voucher :

A voucher is simply a documentary evidence which proves the accuracy or otherwise of a transaction appearing in the books of accounts. The auditor has to depend and rely upon the vouchers to a great extent in order to form an expert opinion about the accuracy and authenticity of the recorded transaction.

Types of voucher :

1. primary voucher
2. collateral voucher

cash receipt
purchase
cash paid
purchase
sales return

Journal entries

points to be considered at the time of conducting vouching.

check vouchers arranged in order.
dates given in voucher should be checked.
Head of account debited or audited.
check the transaction pertains to the business.

Stamp of the voucher should be checked.
complete notes should be taken in respect of item line classification or evidence.

Amount of the voucher should be checked.
alterations of figure should be checked.

Vouching of cash and Trade Transaction
Vouching of cash Receipts:

Points to be kept in mind by an auditor while vouching cash receipts.

A reliable system of internal check is in operations.

All receipts noted in cash book or diary are promptly and properly entered in cashbook.

Receipts books are kept under the control of some responsible staff and all receipts bear serial numbers and carbon copies of the same are kept in the office.

Discount if any is allowed at uniform rate.

All cash receipts are deposited in the bank on daily basis and supported by a

proper voucher.

The important cash receipts are:

Opening Balance:

The closing balance of previous balance sheet should be checked and reference should be made to audit working papers, vouchers balancesheet of previous year cash book.

b) Cash Sales:

Cash sales should be checked with the help of cash memos or cash sales vouchers - cash memos, salesman diary, cashier summaries.

c) Receipt from Debtors:

The counterfoil receipts or carbon copy receipts in support of the entries appearing in the receipts side of cash book should be enquired.

Vouchers: correspondence with debtors, counter foil etc.

d) Income from Interest:

Interest received on account of fixed deposits in the bank should be checked with the bank advice and the arithmetical accuracy of its calculation also should be verified.

Vouchers:

passbook, bank advice, counterfoils

Interest on savings bank account should be checked with bank advice. Interest on loans should be checked with agreement with borrowers. Interest on securities should be checked with correspondence exchanged.

e) Dividend:

Dividend should be vouched with the counterfoils on the upper portion of the dividend warrant and with letters cum interest & ex-interest. Should be checked.

Voucher: counterfoils, dividend, warrants, passbook.

f) Rental Income:

Lease deeds and agreements should be examined in respect of amount of rent receivable. Rent received should be checked with Rent Role.

Vouchers: rent rolls, lease deeds & agreement, counterfoil, correspondence.

g) Commission:

Receipts as to commission should be checked with the amount in the cashbooks.

Vouchers:

Carbon copy of the receipts book and agreement between the client the party.

h) Subscription:

Subscription received should be checked with the counterfoil receipts or the carbon copy receipts with the register of subscribers.

Vouchers: counterfoil, register of subscribers.

(c) Sale of investment:

Sale of investment should be Vouched with broker's advice, cum interest and ex dividend should be checked.

Vouchers: Minutes of board of directors, bank advice etc.

J) Bills receivable:

The amount received against the bill receivable should be Vouched with reference to bills receivable book.

Vouchers: (cash book, pass book, B/R books)

K) Bad debts Recovered:

Receipt from debtors who have become bankrupt should be Vouched with the dividends warrants received from the official receiver or assignee.

Voucher: correspondence with official receiver, client.

(L) Insurance claim:

Amount received in respect of a claim from an insurance company should be Vouched with correspondences exchanged between the client and insurance company.

Vouchers: Agreement, counterfoil.

m) Receipts from Hire purchase:

The auditor should check that the whole amount of an installment is not credited to Sales amount and it has been bifurcated between sales and interest.

n) Sale of fixed assets:

Cash receipts from sale of fixed asset should be vouched with ~~him~~ the correspondence auction notes, agreement of sale, and other evidence.

Voucher: Sale deed account notes, correspondence

o) Miscellaneous Receipts:

Miscellaneous receipts should be checked with correspondence.

Voucher: correspondence, miscellaneous receipts.

Vouching of cash payment transaction:

Examining points:

Name of the client correctly stated as payer
payee name is correctly stated

payee's acknowledgement agrees with cash book.

payment is authorised by a competent person
Head of account correctly done.

Bears proper revenue stamp.

Important of cash payments

a) cash purchases:

Payments for cash purchases should be vouched with cash memos of the suppliers.

Vouchers: cash memos, good inward book etc.

b) Cash paid to creditors:

Enquiry should be made to ensure that invoices have been internally checked and initiated by the authorised officials and payments are authorised.

Vouchers: Statement of accounts, receipts etc.

c) Wages:

An enquiry should be made in respect of the system of preparation of time keeping and pay roll records and the payment procedures and accuracy of internal control.

Vouchers: wages book, wages sheet, wages records, job cards etc.

d) Salaries:

The salary register should be carefully scrutinized and checked.

Voucher: counter foil, of cheques, salaries register, appointment letters.

e) Capital Expenditure:

purchase of freehold and leasehold property.

purchase of plant & machinery

Payment for furniture and fixtures.
Motor vehicles
Patents and copyright
are to be checked with care.

Vouchers:

Invoice, agreement, letter of contract
receipts etc.

f) Investment made:

The original investment should also be
physically examined to ensure their existence
and for acquiring satisfaction that they stood in
the name of the client.

Vouchers: broker's sold note, letter of allotment
share certificate.

g) k) Payment under hire purchase and Installment
agreements:

Vouchers for the payment of each installment
should be seen. Actual hire purchase agreement
'or' agreement to pay by installments should
be examined.

Vouchers:

Agreement, receipts

h) Travelling Allowances:

Travelling allowances bill should be
checked with the rules and the calculations
of the amount may be certified.

(i) Insurance premium:

It should be checked with respect to new policy regarding policy nature demand. role of insurers, receipts issued by insurer, first premium, renewal of old policy.

Vouchers: receipts, policy etc.

(j) freight and carriage:

The railway freight should be vouched with railway receipt, which would be issued by the railway authority. payments in respect of shipping charges should be vouched with the settlement of bill reduced by shipper or carrier.

Vouchers: receipts, bills.

(k) Deferred Revenue Expenditure:

The relevant documentary evidence to prove the truthfulness of the transaction should be examined - accounts, receipts.

(L) Dividend paid:

Nature of the dividend paid must be enquired into. Articles of association should be checked regarding interim dividends.

Vouchers: dividend book, bank statements, unpaid dividend register.

m) Postage and Telephone Expenses:

The audit also should examine the system of internal control in operations relating to incurrence of the postage expenditure.

Voucher: receipts, postage book, signed copy of telegram sent.

n) Bills payable:

Vouching of bills payable should be carried out by checking payments made, payee's acknowledgement should be examined.

o) Payments of Taxes:

Payments on account of income tax and other taxes should be checked with the receipted challans.

Voucher: receipted challans, copy of income tax return filed, notice of demand.

p) Director fees:

Articles of Association and minutes of the meetings of the board should be examined for payment of director's fees.

Vouchers:

Articles of Association, waiver's letter, receipts, minutes book, Special resolution.

Vouching of Trading Transaction:

Purchase Book:

It should be vouched with the invoices, bill of credit memos. The vouched documentary evidence should be cancelled by a rubber stamp or initials of the auditor so that it may not be produced again in support of another entry.

Purchase invoice:

All purchases are made out in the name of the client.

The names of creditor as given on the purchase invoice agree with the purchase book.

The dates of the purchase invoice fall within the financial period under the audit.

The goods mentioned in the invoice are of a ~~new~~ nature in which the business deals in.

The trade discount has been deducted and the net amount of the invoice is entered in the purchase book.

Purchase amount has been properly installed by those who had internally checked it.

allocation of expenditure should be checked to ensure that proper distinction is maintained between capital and revenue expenditure.

Receipt of Goods:

Purchase invoice must be checked with such documentary evidence as will ensure the receipt of goods by the firm.

Inspection Reports:

Goods purchased should be inspected with reports by the responsible official to ensure the correctness of liability.

Tender and quotations:

The purchase invoice should be checked with the tender or quotations and purchase order.

Purchase contracts:

Contracts must be checked to verify the accuracy of the basis on which the invoices have been prepared.

Authorizations:

All entries before being made in the purchase book must be properly authorised by a responsible official.

statements of account:

Test of check of purchase invoice must be checked with the entries of statement.

Forward contracts:

Forward contracts for purchase of goods must be scrutinized and eventual settlement are to be checked.

Duplicate Invoices:

Auditor will scrutinize the relevant account of the creditor in the ledger and make a general scrutiny of the invoices lying to the credit of the respective creditor.

Provisional purchase Invoices:

The auditor should see that the relevant adjustment are made through the final invoices and correct liability is reflected in the books.

Insufficiently vouched purchase invoice:

The missing invoice should be handled over to the management for setting the objections raised. answer should be cleared with the document produced.

Cast and postings:

The cast, cross casts and carry forwards of the purchase book should be checked.

Suppression of purchase

Inflation of purchase

Imports :

The supporting documents such as letter of credit, Foreign invoices, exchange conversion rates, shipping bills of entries clearing and forwarding bills, freight and octroi : receipts, banker advice, bill of exchange etc.

Vouching of Sales Book:

Execution of Sale order:

Should examine the system of the execution of sales order and permanent record of all the permanent record should be checked.

Sales Book:

It should be checked with carbon copy of the invoices, which should be cancelled by the rubber stamp or initials by the auditor.

Sales Invoices:

Invoices is made out in name of debtor.

Name should be tally with invoice and sales book.

Invoice fall within financial period of audit.

deduct the trade discount.

Allocation:

The allocation of sales should be checked, sale and non-sale item should not be matched.

Respatch of goods

Sales invoices must be checked with such documentary evidence as will ensure the dispatch of the goods by the company.

Authorizations

The sales invoices should properly be authorized before being entered in to the sales book.

Statement of accounts

A test check of the amount of the amount of sales invoices with the entries of the statement of accounts.

Tenders and quotations:

The sales invoices should also be checked with tenders or quotations, if called by the client.

Exports:

In case of exports of goods, supporting documents such as sale invoices, exchange conversion rates, shipping bills, clearing and forwarding bills, octroi and freight receipts and banker's advices for the negotiation of documents must be examined.

Forward contracts:

Forward contracts for the sale of goods must be inspected and their eventual settlement should be verified.

Provisional sales invoice:

Auditor should see that the relevant adjustment are made through the final sale invoices and incorporated in the books.

Insufficiently vouched sales invoices:

The missing voucher list should be made.

Costs and postings:

The costs, cross casts and the carry forwards of the sales book should be checked.

Suppression of sales:

The sale book of last two or three weeks of the accounting period & next period should be checked to ascertain whether any of them relate to the period reflected in the period of audited.

Inflation of sales:

A similar work as mentioned in respect of the suppression of sales, if carried out, will uncover any deliberate attempt for inflation of sales.

Sale on consignment basis:

A separate account of the sales in respect of goods received on consignment basis must be ~~maint~~ maintained.

Heavy sales:

The auditor should be satisfy himself that all these goods were delivered prior to the date of closing of financial year.

Vouching of purchase Return Book:

The item should be verified are:

Debit notes:

Name of the client

Name of the client in credit note & purchase return book should be matched.

Date of debit note should ~~be~~ pertain to the financial period of audit.

Internal check should be checked by some staff and duly signed.

Allocation:

The credit to the revenue account should be given in books of client to that head of account, which was previously debited.

Reason for return

The general reasons for the debit note should be enquired into.

costs and postings

costs, cross costs and carry forward of the purchase return books should be checked.

Manipulation:

The entries in the purchase returns book for the early part of the next period should be examined carefully.

Statement of accounts :

A test check of amounts in respect of debit notes sent to creditors into the Statement of accounts should also be done.

Vouching of Bills Receivable Books:

The costs and carry forward of the bills receivable books should be checked.

Vouching of Bills payable Book:

costs, carry forwards and postings of the bills payable book should be checked.

Vouching of Journal proper:

Narration of Journal
authorised signature of responsible officer.

Support of documentary evidence
should be checked.

opening entries, closing entries, transfer entries, Rectification entries. Adjusting entries, Transaction for which there is no other books of original Entry.

checking of purchase ledger

After the books of original entries have been vouched and postings therefrom are fully checked.

costs, list of balances, confirmations
old balances, Dispute cares, debit
balances, Scrutiny should be made.

checking of sales ledger:

Sales ledger is also called Sundry
debtor ledger or accounts receivable
ledger.