MODULE - II: PRACTICAL AUDITING

UNIT- I

Auditing

Nature

Historically, the word '**auditing**' has been derived from Latin word "**audire**" which means "**to hear**". In fact, such an expression conveyed the manner in which the auditing was conducted during ancient time. However, over a period of time, the manner of conducting audit has undergone revolutionary change.

Auditing along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession. No business or institution can effectively carry on its activities without the help of proper records and accounts, since transactions take place at different points of time with numerous persons and entities. The effect of all transactions has to be recorded and suitably analysed to see the results as regards the business as a whole. Periodical statements of account are drawn up to measure the success or failure of the activities in achieving the objective of the organisation. This would be impossible without a systematic record of transactions. Financial statements are often the basis for decision making by the management and for corrective action so as to even closing down the organisation or a part of it. All this would be possible only if the statements are reliable; decisions based on wrong accounting statements may prove very harmful or even fatal to the business. For example, if the business has really earned a profit but because of wrong accounting, the annual accounts show a loss, the proprietor may take the decision to sell the business at a loss. As a result, the independent audit of an entity's financial statements is a vital service to investors, trade payables, and other participants in economic exchange.

Meaning

"An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

Need

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

Objectives

Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Scope

Financial audit is intended to provide a 'reasonable' assurance over the accuracy of financial statements. It therefore does not provide absolute assurance that the financial statements are free from all misstatements.

Principles

The basic principles as stated as below

1) Integrity, objectivity and independence
2) Confidentiality
3) Skills and competence
4) Work performed by others
5) Documentation
6) Planning

Expression of opinion

The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Fraud and error

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management. It is important that those charged with governance and management place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place. The auditor is not and can not be held responsible for fraud and errors, but through his work he can play a positive role in preventing fraud and errors, by deterring their occurrence.

Internal audit and external audit

Internal audit is a function that, although operating independently from other departments and reports directly to the audit committee, resides within an organisation (i.e. they are company employees). It is responsible for performing audits (both financial and non-financial) within a wide range of areas within a business, as directed by the annual audit plan. Internal audit look at key risks facing the business and what is being done to manage those risks effectively, to help the organisation achieve its objectives

External audit is an independent body which resides outside of the organisation which it is auditing. They are focused on the financial accounts or risks associated with finance and are appointed by the company shareholders. The main responsibility of external audit is to perform the annual statutory audit of the financial accounts, providing an opinion on whether they are a true and fair reflection of the company's financial position.

Auditing and Investigation

An audit is the inspection, examination or verification of a person, organization, system, process, enterprise, project or product. It is used to determine the authenticity and validity or to ensure that a process is being followed. Also, an audit is mainly used in accounting to ensure the validity and reliability of information in the statements and that the information is free from material error. An audit can be done anytime.

An investigation is the process of detailed examination of activities so as to achieve certain objectives. It is the act of investigating; or is the study to enquire about a particular thing. It is an important factor in journalism for investigating various cases. It is the best method to tackle or identify the case; and make a thorough report about the case. Investigation is made in suspected places. In this, the main focus is on an inquiry into the accounts and financial matters of a business and to the overall aspects of it.

Auditing Standards

These Standards will apply whenever an independent audit is carried out; that is, in the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon. While discharging their attest function, it will be the duty of members of the Institute to ensure that the Standards are followed in the audit of financial information covered by their audit reports. If for any reason a member has not been able to perform an audit in accordance with the Standards, his report should draw attention to the material departures therefrom.

UNIT- II

Audit Planning and Control:

Audit Planning

The auditor should plan the audit so that the engagement will be performed in an effective manner. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan, in order to reduce audit risk to an acceptably low level. Planning involves the engagement partner and other key members of the engagement team to benefit from their experience and insight and to enhance the effectiveness and efficiency of the planning process.

Engagement letter

According to SA 210 “Agreeing the Terms of Audit Engagements”, the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate.

The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

(a) The objective and scope of the audit of the financial statements;

(b) The responsibilities of the auditor;

(c) The responsibilities of management;

(d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and

(e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Audit Programme

An auditor prepares a plan after the selection of senior and junior staffs allocating the jobs to them, mentioning when to start, how to do the work etc. This plan is known as audit program.

* Audit program is a detailed work plan which includes the time of doing work and how to do the works.

* Audit program includes audit procedures

* Audit program estimates the duration to complete the audit task

* Senior staffs prepare audit program to junior staffs on the basis of nature of business

Following points should be included in audit program:

* Detail information of works of all the junior staffs like audit of bank/ cash book, purchase book, sales book etc.

* Auditor should prepare audit program considering the nature of client.

* Separate list of work assigned to assistant should be prepared by the auditor.

* Audit program should fix the time period to complete jib assigned to the assistants.

* Assistant should sign after the completion of his/her job.

Audit notebook

An audit note book is usually a bound book in which a large variety of matters observed during the course of audit are recorded. It is thus a part of the permanent record of the auditor available for reference later on, if required. The audit note book also provides a valuable help to the auditor in picking up the links of work when the concerned assistant is away or the work is stopped temporarily because in it are recorded along with observations, the various queries, explanations obtained and evidence seen, while queries remaining undisputed of would be noted for follow up. It is more satisfactory in some ways, however, to use loose sheets for entering queries and notes which, subsequently, on being punched, may be filed in a special query file maintained for each client or along with the clients' accounts and papers, separately for each year.

Audit Documentation

The auditor shall document-

a) The overall audit strategy
b) The audit plan; and
c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

Audit Working Papers

A record of the auditors' work should be retained in the form of working papers. Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

I. Importance of Working Papers
II. It provides guidance to the audit staff with regard to the manner of checking the schedules.
III. The auditor is able to fix responsibility on the staff member who signs each schedule checked by him.
IV. It acts as evidence in the court of law when a charge of negligence is brought against the auditor.
V. It acts as the process of planning for the auditor so that he can estimate the time that may be required for checking the schedules.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention.

<u>Audit files:</u> Permanent and current audit files

In the case of recurring audits, some working paper files may be classified as permanent audit files which are updated currently with information of continuing importance to succeeding audit, as distinct from current audit files which contain information relating primarily to the audit of a single period.

A permanent audit file normally includes:

- Information concerning the legal and organisational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.
- Extracts or copies of important legal documents, agreements and minutes relevant to the audit.

- A record of the study and the evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
- Copies of audited financial statements for previous years.
- Analysis of significant ratios and trends.
- Copies of management letters issued by the auditor, if any.
- Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.

- Notes regarding significant accounting policies.
- Significant audit observations of earlier years. The

Current file normally includes:

- Correspondence relating to acceptance of annual reappointment.
- Extracts of important matters in the minutes of Board Meetings and General Meetings as relevant to audit.
- Evidence of the planning process of the audit and audit programme.
- Analysis of transactions and balances.
- A record of the nature, timing and extent of auditing procedures performed, and the results of such procedures.
- Evidence that the work performed by assistants was supervised and reviewed.
- Copies of communication with other auditors, experts and other third parties.
- Letters of representation or confirmation received from the client.
- Conclusions reached by the auditor concerning significant aspects of the audit, including the manner in which exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated.
- Copies of the financial information being reported on and the related audit reports.

Ownership and custody of working papers

Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client. Audit working papers are the property of the auditor and he is entitled to retain them. Firms are required to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

UNIT- III

Audit Evidence and Internal Control:

Audit Evidence

Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Audit Procedures for obtaining evidence

Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

(a) Risk assessment procedures and

(b) Further audit procedures, which comprise:

(i) Tests of controls, when required by the SAs or when the auditor has chosen to do so and

(ii) Substantive procedures, including tests of details and substantive analytical procedures

Sources of evidence

Some audit evidence is obtained by performing audit procedures to test the accounting records.

For example-

- through analysis and review,
- reperforming procedures followed in the financial reporting process, and reconciling related types and applications of the same information.

Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements.

More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.

Reliability of audit evidence

The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based. The reliability of information to be used as audit evidence, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance .

The following generalisations about the reliability of audit evidence may be useful:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

Methods of obtaining audit evidence

The auditor obtains evidence by performing compliance and substantive procedures by the following methods

- Inspection
- Observation
- Inquiry and Confirmation
- Computation
- Analytical Review

Physical Verification-Documentation

A significant method used in gaining sufficient appropriate audit evidence is the use of selection and sampling techniques. SA 500 suggests three methods of obtaining audit evidence: Selecting all items (100% sampling), Selecting specific item and audit sampling.

Internal Control: Review and Documentation

Meaning

The internal control may be defined as "The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations.

So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded.

Review

The review of internal controls will enable the auditor to know:

(i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;

(ii) whether an adequate internal control system is in use and operating as planned by the management;

(iii) whether an effective internal auditing department is operating;

(iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);

(v) whether the controls adequately safeguard the assets;

(vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned

Documentation

Internal control documentation can take various forms, including flowcharts, policy and procedure manuals, and narrative descriptions. In most instances, internal auditors use flowcharts supplemented by narrative descriptions as a starting point for documentation work. Once these items are completed, auditors often use risk and control matrices for more specific analysis.

Flowcharts

Auditors use flowcharts to describe the flow of activity through a process, as well as the relevant documentation. The main output of a flowchart is a process map — a graphical representation of events performed by a group of people.

Narrative Descriptions

Narratives describe process flows in written form, without graphical representations. They provide a useful supplement to flowcharting documentation by detailing existing practices and thereby minimizing potential misunderstandings

Internal Control Questionnaires

Completed ICQs list answers to questions related to the identification and evaluation of internal controls. Effective ICQ documents comprise a carefully structured, logically sequenced series of questions that help management and internal auditors document processes and highlight control gaps, strengths, and weaknesses within a system.

Risk and Control Matrices

Risk and control matrices link controls with control objectives and related risks. They are designed both to document risks and controls and to facilitate evaluation of the design and effectiveness of the control system.

Policy and Procedure Manuals

Policy and procedure manuals establish a systematic framework and sound guidelines for the specific processes and activities of an organization, facilitating effective implementation of business strategy on both a strategic and operational level.

Internal control checklist

An effective internal control system enables you to manage significant risks and monitor the reliability and integrity of financial and operating information.

Cash Receipts

- Are checks endorsed "for deposit only" immediately upon receipt?
- Are duplicate deposit slips and copies of checks retained in the files?
- Are all cash and checks deposited intact and on a timely basis?

Cash Disbursements

- Are all disbursements, except those from petty cash, made by pre-numbered checks?
- Are employees required to submit expense reports for all travel related expenses on a timely basis?
- Are bank statements and cancelled checks received and reviewed by a person independent of the accounting functions?

Petty Cash

- Is a petty cash fund maintained for payment of small, incidental expenses?
- Is supporting documentation required for all petty cash disbursements?
- Is access to petty cash limited to one person who is the fund custodian?

Payroll

- Are time sheets signed by employees and reviewed and signed by their immediate supervisors?
- Do written policies and procedures exist for accounting for vacations, holidays, sick leave, and other benefits?

Tests of control

Procedures designed to evaluate the effectiveness of the design and operation of internal controls. Auditor assesses whether the control has been properly designed to prevent or detect a material misstatement in the financial statements

Examples of tests of controls:

-Inspecting documents/reports for evidence the control has been performed. Example: HR manager signs the payroll as evidence of her/his review before the payroll is finalized and the cheques are issued.

-Observation of the application of specific controls. Example: auditor observes the cashier perform sales transactions and notes that the cash register will not open unless a sale has occurred.

-Walkthroughs – tracing a transaction from its point of origin to its inclusion in the financial statements. Involves several audit procedures: enquiry, observation, inspection. Example: the purchase of a capital asset is traced from the purchase order to the inclusion on the financial statements, ensuring required approvals, categorization of asset, and amortization policies are applied.

-Reperformance of the application of the control by the auditor – test ensures the integrity of the control. Example: recalculating the sales commissions paid on a sample of sales transactions.

Application of concept of materiality in auditing

The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles. The representation in the auditor's standard report regarding fair presentation, in all material respects, in conformity with generally accepted accounting principles indicates the auditor's belief that the financial statements taken as a whole are not materially misstated.

UNIT- IV

Audit of Payments and Receipts:

Audit of Payments

General Consideration

An auditor, therefore, should see that the receipts produced in evidence of payments, shown to have been made are properly stamped. The date of issue of a stamp paper from the stamp office is entered on its back. The design on revenue stamp also is changed from time to time. The date of issue of a stamp paper from the stamp office is entered on its back. It would also be advisable for the auditor to refer other connected documents, viz., invoices, debit notes, etc. against which payments have been made before accepting such receipts as evidence of payment of money.

Wages

Payments on account of wages need to be vouched carefully, since amounts which were either not due or in excess of those due may have been paid by the client.

Therefore, before proceeding to verify payment made on account of wages, the auditor should examine the internal control procedure as regards the following:

(a) Recording attendance of workers engaged on the time basis, as well as particulars of jobs performed by piece workers

(b) Arrangement for the preparation of wages and salaries bills and their analysis.

(c) Appointment, promotion, transfer and discharge of employees.

(d) Sanctioning the disbursement of wages.

(e) Arrangement for disbursement of wages for workers and employees not present on the pay day.

(f) Custody of the wages records.

Petty cash payments

Payments from petty cash should be verified as follows:

(i) Trace the amounts advanced to the petty cashier for meeting petty office expenses from the Cash Book in the Petty Cash Book.

(ii) Vouch payments with docket vouchers which must be supported, wherever possible, by external evidence e.g., payee's receipted bill or invoices, cash memo, etc.

(iii) Trace payments made for the purchase of postage stamps recorded in the Postage Book. The totals of the Postage Book should be test checked. The amounts of postage stamps in hand, at the end of the year, should be credited to Postage Account by debiting the amounts to Postage in Hand Account. It should be seen that the amount paid for postage stamps is not unduly large and the Postage Book is normally checked by the petty cashier from time to time before the amount of imprest is reimbursed. Confirm that the postage expenses for the year are reasonable as compared with that in the postage expenses from month to month.

(iv) See where a columnar Petty Cash Book is maintained, that the extension have been carried forward into appropriate amount columns.

(v) Check the column totals and cross totals.

(vi) Trace posting of the various columns in which payments are classified to the respective ledger accounts.

(vii) Verify the cash balance in hand.

Audit of Purchases and purchase returns

Cash purchases should be verified by reference to cash memos or receipted invoices by suppliers. Payments made against credit purchases should be vouched with the receipts issued by the suppliers and the credit to their accounts on the basis of invoices entered in the Purchases Day book. There must be also evidence of the goods having been received through an entry in the Goods Inward Books or inventory ledger.

If a part or whole of a consignment of goods found to be defective or of a poor quality, the goods sometime are returned to the supplier and his account is debited. The debit is raised in the Purchase Returns Books, on the basis of Debit Note. The supplier, on receiving the Debit Note, issues Credit Note indicating his acceptance of the debit. Where the purchase returns are large, either at the beginning or at the close of the year, these might be fictitious, entered to cover bogus purchases recorded earlier. On such a consideration the nature thereof should be ascertained. The rebate in price and allowances granted by the suppliers should be adjusted through the journal on the basis of Credit Notes received from the suppliers. These should be verified by reference to the original invoices.

Audit of payments into and out of the bank

Apart from comparing the entries in the cash book with those in the Pass Book the auditor should obtain a certificate from the bank confirming the balance at the close of the year as shown in the Pass Book. If the bank account is overdrawn, the auditor should obtain from the bank particulars of assets on which a charge has been created to secure the overdraft. The auditor should examine the bank reconciliation statement prepared as on the last day of the year. He may also examine the reconciliation statement prepared as on the last day of the year. He may also examine the reconciliation statements as at other dates during the year. It should be examined whether (i) cheques issued by the entity but not presented for payment, and (ii) cheques deposited for collection by the entity but not credited in the bank account, have been duly debited/credited in the subsequent period.

Reconciliation

A copy of the statement duly signed by the accountant of the client after it has been checked should be kept in record by the auditor along with other working papers, for future reference. The position of cheques and other remittances shown in the statement as outstanding should be ascertained on a reference to the Bank Pass Book. Where it is found that a number of cheques have been deposited in the bank immediately before the close of the year, which subsequently were dishonoured, it should be investigated whether these were fictitious which had been deposited merely to inflate the bank balance or to show parties' balances outstanding against whom balances were infact irrecoverable. Generally, it is advisable that the position of all amounts deposited in the bank, which were outstanding for realisation at the close of the year, should be ascertained.

<u>Audit of receipts</u>

General Consideration

Receipts are usually checked with counterfoils of the receipts issued. But the issue of receipts with counterfoils in respect of amounts collected by it would not ensure that all the amounts collected have been fully accounted for or have been correctly adjusted. For instance, a receipt might be issued for a larger amount than entered on its counterfoils. Again, only one receipt might have been issued for two or more amounts collected from a party while the counterfoils may show that separate receipts have been issued in respect of each amount collected and the one or more receipts forms, thus saved, may have been used for issuing a receipt of another amount collected which have been misappropriated. Therefore, before accepting counterfoils or receipts as evidence or the correctness of the amount collected, the auditor should satisfy himself that there exists an efficient system of internal check which would prevent any receipt from being misappropriated

Cash Sales

Cash sales usually are verified with carbon copies of cash memos. If sales are quite voluminous then a Cash Sales Summary Book is maintained and the cash memos are traced into it; the totals of the Summary Book are verified and the daily totals of the Summary book traced into the Cash Book. One of the matters, to which attention of the auditor should be paid in the process, is that the dates on the cash memos should tally with those on which cash collected in respect thereof has been entered in the Cash Book.
To verify that price of goods sold has been calculated correctly; the computation of the sales should be ascertained. If a cash memo has been cancelled, its original copy should be inspected, for it could be that the amount thereof has been misappropriated.

Receipts from debtors

Receipt of cash from the account receivables against price of goods sold are checked with the counterfoils of receipt issued to them. At the same time, it is also verified that there is a system of internal check in operation which acts as a safeguard against amounts collected being misappropriated.
One of the common devices for misappropriating cash collections from account receivables is the one known as Teeming and Lading. Such a fraud, usually, remains undetected for long since the cashier is able to make good the amounts misappropriated before the cash balance is checked. At times, the cashier who has committed such a fraud may cover up the amounts misappropriated, by raising a fictitious debit in an expense account.

Audit Report

An audit report should be clear, specific and complete, in order that anyone who has an occasion to read it may know exactly what is wrong with the company. An Auditor who gives the shareholders "the means of information" in respect of company's financial position, does so, at his peril and runs the serious risk of being held judicially to have failed to discharge his duty.

The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements.

The auditor's report should contain a clear written expression of opinion on the financial statements taken as a whole.

Qualifications

(1) The auditor shall express a qualified opinion when:

(i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Disclaimers

The auditor shall disclaim an opinion when theauditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Disclosures

In the case of a company, members should quality their audit reports in case

(a) accounting policies required to be disclosed under Revised Schedule VI or any other provisions of the Companies Act, 1956 (now Schedule III of the Companies Act, 2013) have not been disclosed, or

(b) accounts have not been prepared on accrual basis, or

(c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or

(d) Proper disclosures regarding changes in the accounting policies have not been made.

Where a company has been given a specific exemption regarding any of the matters stated above but the fact of such exemption has not been adequately disclosed in the accounts,

the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.

In view of the above, the auditor will have to consider different circumstances whether the audit report has to be qualified or only disclosures have to be given.

In the case of enterprises not governed by the Companies Act, the member should examine the relevant statute and make suitable qualification in his audit report in case adequate disclosures regarding accounting policies have not been made as per the statutory requirements.

Reports and certificates

Audit Report is an expression of opinion about the account.The report is based on assumptions and estimations. The scope of report is large. After the end of each accounting year report is mandatory. As a report is merely an opinion, if it is not correct, the auditor may not be held responsible.

It is a confirmation of correctness and accuracy about some matters. Certificate is based on actual figures and facts. Its scope is limited. Certificate is not mandatory in every year. In case of wrong certificate, the auditor will be held responsible.

UNIT- V

Audit of Sales, Assets and Liabilities

Audit of sales

1. Sales Process & Revenue recognition process (IAS/BAS 18, IAS 11/BAS 11)
2. Identify control over sales
3. Check implementation of controls over sales & check if the it complies with the process.
4. Substantive procedures over sales.
5. Cut-off of sales

Goods on consignment

Where a separate account in respect of each consignment is not being maintained and only memoranda accounts in respect of goods sent on consignment are kept, the auditor should make sure that inventories sent out on consignment but unsold have been included in the closing inventory; when a separate account in respect of each consignment is being maintained, the auditor should verify that the debit balance in each Consignment Account represents only the cost of unsold goods plus proportionate expenses incurred on their transport and transit insurance; also that a provision has been made or any damage or loss suffered by the inventory or for a fall in sale price.

Sales Returns

The auditor should vouch it with the credit notes issued to the debtors.
While checking the credit notes issued particular attention should be given to the following points.

1. Name of client.
2. Debtors name agrees with the sales return book.
3. Date falls within the financial period.
4. Whether checked by staff member & it bears his initial in token of internal checking

The debit to revenue account should be given in the books of client to that head of account which was previously credited. The general reason for the debit note should be inquired in to correspondence on the subject should be carefully read, when the auditor feels doubtful about the accuracy of entries.

Sales Ledger

An auditor determines if the financial statement amounts of sales and accounts receivable are correct by verifying individual transactions. Accounts receivable balances are tested by sending confirmation letters to customers to obtain objective assurance that the balance is correct. The auditor also chooses sales transactions from the sales ledger and verifies that there are legitimate sales receipts to back up the transaction. To test the accuracy of the sales figure, the auditor reviews sales transactions in the ledger close to the financial statement date to ensure that the company only included sales prior to that date.

Audit of supplier’s ledger

1. The structure of every account in the bought ledger; opening balance, credits on account of goods purchased and debits raised in respect of return, allowances and discount receivable, advances paid against goods payments and transfers.
2. The accounts in the bought ledgers usually are in credit.

Debtor’s ledger

The structure of each account in the sales ledger is opening balance, debits representing values of goods sold, payments made for goods returned and transfers, credit representing amounts received for good sold, advances received against order, discount and allowances allowed, value of goods returned back and debts written off.

Control Accounts

A control account is a summary account in the general ledger. The details that support the balance in the summary account are contained in a ledger. The purpose of the control account is to keep the general ledger free of details, yet have the correct balance for the financial statements. For example, the Accounts Receivable account in the general ledger could be a control account. If it were a control account, the company would merely update the account with a few amounts, such as total collections for the day, total sales on account for the day, total returns and allowances for the day, etc.

The details on each customer and each transaction would not be recorded in the Accounts Receivable control account in the general ledger. Rather, these details of the accounts receivable activity will be in the Accounts Receivable Subsidiary Ledger. This works well because the employees working with the general ledger probably do not need to see the details for every sale or every collection transaction.

Provision for bad and doubtful debts

The provision for doubtful debts is the estimated amount of bad debt that will arise from accounts receivable that have been issued but not yet collected. It is identical to the allowance for doubtful accounts. The provision is used under accrual basis accounting, so that an expense is recognized for probable bad debts as soon as invoices are issued to customers, rather than waiting several months to find out exactly which invoices turned out to be uncollectible. Thus, the net impact of the provision for doubtful debts is to accelerate the recognition of bad debts into earlier reporting periods.

The auditor should verify whether adequate estimate of the provision has been made.

Audit of Impersonal Ledger

- Has two kinds of accounts, viz. nominal accounts which relate to the Trading & Profit and Loss Accounts and Real Accounts which records assets.
- If the accounts in the general ledger are incorrect, they will affect the Profit & Loss account and the balance sheet.
- It is the final review of balances which on inclusion in the final account, cumulatively

reflect the financial position of the concern.

- The certificate which an auditor will sign, will, therefore, be incorrect in the event the final accounts do not reflect the true financial position of any concern.
- Entries in the general ledger usually are posted in a summary form from the cash book, the journal, and other subsidiary books like purchase book, sales book etc.

Capital Expenditure

A capital expenditure is that which is incurred for the under mentioned purposes-

(a) Acquiring fixed assets, i.e., assets of a permanent or a semi-permanent nature, which are held not for resale but for use with a view to earning profits.

(b) Making additions to the existing fixed assets.

(c) Increasing earning capacity of the business.

(d) Reducing the cost of production.

(e) Acquiring a benefit of enduring nature of a valuable right.

Whenever, therefore, a part of the expenditure, ostensibly of a revenue nature, is capitalised it is the duty of the auditor not only to examine the precise particulars of the expenditure but also the considerations on which it has been capitalised.

Deferred Revenue Expenditure

This refers to expenditure essentially of a revenue nature which, instead of being charged off as and when it is incurred, is accumulated in an account appropriately headed to indicate its nature and the balance in the account is written off over a period of years during which its benefit is expected to accrue to the business. Examples of expenses are: prepaid expenses, discount allowed on subscription to debentures. As long as the expense is not written off, it continues to appear as an asset on the right hand side of the Balance Sheet. Such expenses are described as Deferred Revenue Expenditure so as to indicate clearly the fact that though the expense is essentially of a revenue nature, its writing off has been deferred for adequate reasons.

For verification of such expenditure, it is necessary for the auditor to examine the evidence showing that the expense has actually been incurred as well as the proposed basis of its apportionment over a period of years.

Revenue Expenditure

An expenditure, the benefits of which is immediately say within one year expended or exhausted in the process of earning revenue, for example on purchase of goods for sale,

on their movement from one place to another, on maintaining assets, on keeping a business organization going, etc. Examples of revenue expenditure are-

(i) Cost of raw material and stores consumed in the process of manufacture.

(ii) Salaries and wages of employees engaged directly or in-directly in production.

(iii) Repairs and renewals of fixed assets.

(iv) Advertisements

(v) Postage

Outstanding expenses and income

Normally, every item of expenditure has to be written off in the year in which it is incurred. But, considering the requirement of AS 10 and AS 26, the expenses relating to tangible and intangible assets can be capitalised if recognition criteria are met. It may be noted that with the issuance of AS 26, "Intangible Assets", the concept of deferred revenue expenditure is no more in existence.

If the provision for outstanding expenses made in a past year turns out to be insufficient and the amount is material, proper disclosure of such a fact should be made in the accounts of the year in which any further amount is charged on that account. This is done either by showing the amount separately in the inner column and explaining its nature or by including it in the Appropriation Section of the Statement of Profit and Loss.

The following are some of the accounts in which adjustment of outstanding income could be made:

(i) Rent receivable: All rents receivable due or accrued to the date of the Balance Sheet should be calculated and brought into account, after a provision has been made for doubtful or irrecoverable arrears of rent, allowance for repairs, etc.

(ii) Interest and dividend: Interest receivable on loans accrued to the date of the Balance Sheet should be brought into accounts in all cases where the interest is being regularly received on the dates.

Audit of Assets and Liabilities

The act of examining/establishing the existence and valuation of Assets and Liabilities may be referred to as Verification. While verifying the assets and liabilities of an entity, an auditor is required to have knowledge of applicable Accounting Standards, for e.g., AS 6 on Depreciation, AS 10 on Fixed Assets, AS 26 on Intangible Assets, etc. The auditor is further required to check the presentation of various items in the Balance Sheet and Statement of Profit and Loss, for e.g., as per Schedule III to the Companies Act, 2013 in the case of a company.

Audit of share capital and transfer of shares

Share Capital

The auditor should examine the following books and documents for the purpose of auditing Share Capital newly issued:

(i) Memorandum of Association,

(ii) Articles of Association,

(iii) Prospectus,

(iv)Directors' Minute Book,

(v) Application for Shares,

(vi) Application and Allotment Book,

(vii) Copies of Letters of Allotment

Share Transfer

It is no part of an auditor's duty to check the share transactions in detail but he is usually asked to undertake the audit of share transfer for which he is paid an extra remuneration.

Its objects are:

(i) To prevent clerical errors, and
(ii) To prevent the improper issue of Duplicate Share Certificates or certified transfers (whether fraudulently or otherwise).