

Course: Auditing (5417)
Semester: Spring, 2021
ASSIGNMENT No. 1

Q.1 Define auditing and describe its various techniques.

Audit procedures are the processes, techniques, and methods that auditors perform to obtain audit evidence which enables them to make a conclusion on the set audit objective and express their opinion. Sometimes we call audit procedures audit programs.

These two terms are referring to the same thing.

Auditors normally prepare audit procedures at the planning stages once they identified audit objectives, audit scope, audit approach, and audit risks.

Auditors design audit procedures to detect all kinds of risks that they identified and ensuring that the required audit evidence is obtained sufficiently and appropriately.

Normally, audit partners need to approve on audit plan and audit procedures before the audit team could perform their testing. This is to make sure that all concerns or risks are address in the procedures.

Audit procedures might be 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 change from time to time.

The auditor might need to update audit procedures from time to time event thought current financial statements had been audited by its firm or team.

Typically, there are five audit procedures that normally use by auditors to obtain audit evidence. Those five audit procedures include Analytical review, inquiry, observation, inspection, and recalculation.

List of Five Types of Procedures:

1) Analytical Review:

Analytical review is not the procedure that uses to obtain audit evidence, but it is the procedure used to assess the unusual transactions or events as the principle or basic to perform other procedures.

For example, when auditor found there is unusual transactions or event as the result of using analytical review, then the auditor will use other procedures that are applicable to obtain evidence.

The analytical procedure could be used for the types of transactions or events that occur regularly or have a connection with others' transactions or events.

For example, we can use the analytical procedure to assess the reasonableness of depreciation that records in the financial statements. The main reason is that depreciation expenses are calculated systematically and occur regularly.

2) Inquiry:

Auditors inquire accountant and related management to gather information and obtain an explanation on the mater that found by auditors.

Sometimes auditors inquire about management about the business process and the ways how financial transactions are recording as well as the major control on business transactions.

The inquiry is also one of the most important audit procedures and it could be used in different stages.

For example, the auditor might inquire management at the planning stage and the auditor could also inquire management to confirm the consignment liabilities at the end of the audit work.

Audit inquiry is sometimes used by the auditor to obtain the audit evidence and sometimes is used to obtain an understanding of some nature of business or accounting transactions in order to gain enough knowledge to design and perform testing.

3) Observation:

Observation is one of the audit procedures that auditors use to obtain an understanding and gather audit evidence mainly to the real process or the ways how clients have done some specific business process.

This kind of audit procedure is mainly to confirm the process that the client told, physical confirmation, or some time used to obtain audit evidence in order to make their own projection which will be used for comparison with the client figure.

For example, auditor joins client stock take at the year-end and observe whether the way that they count are in the correct procedures or not.

In this procedure, the audit is not confirmed whether the client counts their inventories correct or not, but it confirms whether the client counting procedure is correct or not is one thing.

Another thing is the auditor tries to confirm whether the counting has really existed.

However, in practice, sometimes the auditor is not only observed how the client counts but they also jointly perform counting inventories.

Sometimes auditors using observation are not only for observing in counting fixed assets or inventories but also using to test the reasonableness of revenue. Here is how,

For example, the auditor performs the reasonableness testing of revenue recording in the restaurant, and based on the accounting record fact check with their understanding, the revenue seems not completely records.

In this case, the auditor might perform one week or two weeks observe in the restaurant and then make their own estimate of whether or not the revenue is reasonable.

4) Inspection:

Inspection refers to verification or vouching documents. This is one of the most important and it can be 60% of audit work involve with the inspection of documents.

For example, the auditor examines the sales invoices that record in financial reports.

The auditor might examine whether the invoice issued by the client is really based on the goods that receive. And the goods that received is actually the one the company makes an order.

The auditor might also examine the payment voucher against the authority that approves the payment vouchers.

The auditor might also inspect the supporting documents recording the inventory's movement during the year.

This is including the documents related to purchasing raw material.

5) Recalculation:

Recalculation is the type of audit procedure that normally done by re-performing the works performed by the client in the purpose of assessing if there any difference between the audit's work and the client's work.

For example, the auditor might re-perform depreciation calculation and assess if there any difference between auditor calculation and its client's calculation.

The auditor might also perform the recalculation on monthly salary expenses that prepare by the payroll and finance department to ensure that the net salaries that paid to the employee are correct.

Recalculation is the procedure that use to confirm the accuracy of transaction that involves calculation.

Q.2 What do you know about audit program? Describe the characteristics of an audit program.

An audit program provides a basic plan for the audit team regarding the entity's business, its size, how to conduct the audit, allocation of work among team members and the estimation of time within which it should complete the work.

It contains details regarding the relevancy of evidence, materiality level, risk tolerance, measure of the sufficiency of the evidence. Thus, programs enhance the accountability of the audit team and its members for the work performed by them.

An auditor may revise the audit program if he considers it necessary due to prevailing circumstances. The size of the entity, type of business or services in which entity deals, applicable laws, the effectiveness of internal controls, and various other relevant factors, also affect an audit program.

Thus, an auditor prepares an audit program according to its scope of work. The minimum essential work to be performed is the Standard Programme. However, there is no set audit standard program applicable in all the circumstances.

Audit working papers document the activities that the audit program performs. Audit working papers support the work performed by the auditor for providing assurance that the audit was performed in accordance with all the applicable standards on auditing (SA's). It helps the auditor in the proper execution of audit work.

An audit program covers various steps of auditing in an audit program like the assessment of internal control, ascertaining accuracy and reliability of books of accounts, inspection, vouching and verification, valuation of assets and liabilities, scrutiny of accounts, presentation of financial statements, and submission of reports and related disclosures.

Advantages of the Audit Programme

1. An audit program helps in ensuring that all-important areas are considered while conducting the audit.
2. An audit program helps an auditor in the allocation of work among its team members according to their skills and competency.
3. It enhances the accountability of audit team members towards work performed by them
4. An audit program also reduces the scope for misunderstanding among team members regarding the performance of audit work.

5. It helps the auditor in checking the status of audit work, its progress, how much it is left for performance while conducting the audit.
6. Auditor prepares audit working papers which contains a record of various audit procedure applied which serves as evidence against the charge of negligence.
7. Audit program enables the auditor to keep a record of useful information specifically for future audit and references.

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Disadvantages of Audit Programme

1. **Rigidity:** There is no set standard audit program that can be applied in the case of every entity. However, programs differ for different types of entities. Every entity has its own problems. Therefore, we cannot apply for a single audit program in the case of all business entities.
2. **Reduces the Initiative of Efficient Staff:** – A program reduces the initiatives of efficient and competent staff. Thus, staff members cannot make changes in the audit plan and cannot make suggestions to it.
3. **Audit Work becomes Mechanical:** The program becomes mechanical when it ignores other aspects like internal control.
4. **Overlooking New Areas:** A program may overlook the new areas. With the change in time and technology, new problems may arise which an audit program may not consider.

Q.3 Define vouching, also explain the techniques and objectives of vouching.

Vouching is the soul of Auditing because it forms a base for an effective audit procedure. Vouching means “to vouch” i.e. examine the vouchers. On the other hand, **Verification** means “to verify” the assets and liabilities of the business. Both the two terms are the first two steps of Auditing, infact vouching helps in the process of verification.

In firmer terms, Vouching implies the act of checking the vouchers, to identify the authenticity of the transactions recorded. Conversely, Verification alludes to a process, adopted by the auditor to examine the assets and liabilities.

To a layman, these two processes are one and the same thing, but they are different. So, here is an article presented to you which attempts to shed light on the differences between Vouching and Verification, which we have compiled after a thorough study on the two.

BASIS	FOR	VOUCHING	VERIFICATION
COMPARISON			

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Meaning	Vouching means checking the accuracy of the transactions recorded in the books of accounts.	Verification means a process to substantiate the validity of assets and liabilities appearing in the Balance Sheet.
Basis	Documentary Evidence	Observation and Documentary Evidence
Examination of	Items of Profit & Loss account	Items of Balance Sheet
Carried out by	Audit clerks	Auditor
Time Horizon	Year-round	At the end of the financial year.
Objective	To examine the correctness, validity and completeness of the transactions.	To confirm the ownership, possession, existence, valuation and disclosure of the items appearing on the Balance Sheet.

Vouching is a process of checking the vouchers related to the transactions recorded in the books of accounts, by an auditor himself or by his assistant or by an audit clerk.

The basic purpose of auditing is to check the validity of the transactions, appearing in the books. It is to ensure that whether the transactions recorded in the primary books of accounts are matched with the documentary evidence or not. It also helps in checking that the amount mentioned in the transaction is accurate, and the vouchers are free from errors regarding totaling and casting. The auditor will trace the list of missing vouchers. Additionally, the auditor may also check proper disclosures have been made in the final accounts.

Here, documentary evidence means vouchers, which includes invoices, receipts, bank statements, bills, debit note, credit note, etc. It is the fundamental document, which works as a basis of accounting entry. Vouchers need to be duly signed, stamped, dated and numbered consecutively. It must be complete in all respects, belongs to the concerned financial year and clearly reveals the nature of the transaction. In general, Verification refers to the establishment of fact or truth. In the context of auditing, Verification is a procedure of examining and confirming the ownership, actual existence, valuation and possession of the assets and liabilities appearing in the Balance Sheet. It is conducted at the end of the accounting period.

The major objective of verification is to authenticate the correlation of actual details with those represented in the Statement of Financial Position. Further, the auditor may check:

- The accuracy and reliability of the annual accounts.
- The transactions are authorized or not.
- The assets and liabilities are recorded properly.

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- Valuation of assets is done in a proper way.
- The ownership, cost, and possession of the asset.
- Proper disclosures are made or not.
- Detection of fraud and error.

Vouching is the most basic function performed by the auditors to test the validity of vouchers in relation to the transactions represented in the Income Statement. Verification is a little different as well as difficult process; it requires in-depth examination and observation of the annual accounts to know the authenticity of the items appearing in the Balance Sheet. The auditing procedure starts with vouching and the next step for the same is verification.

Q.4 Differentiate internal control, internal check, and internal audit. Also, explain the major responsibilities of an internal auditor.

The internal control structure of a company consists of the policies and procedures established to provide reasonable assurance that specific entity objectives will be achieved.

In small business organizations, generally, the owner-manager controls the total activities of his business by his personal supervision and direct participation.

For example;

The owner generally purchases required business materials and other properties.

He himself gives the appointment of employees, completes the contract with them through discussion and also keeps, constant watch over their activities.

He himself signs cheques for payments in different heads.

Since he signs all the cheques, he can easily have an idea of what commodities, assets, and services he is signing for.

But with the expansion of business, the appointment of additional employees and officers is needed and the scope of business also widens.

Under such conditions, it becomes almost impossible on the part of the manager to perform all the activities of the business alone for which he is to delegate authority and so his overall control tends to decrease.

The internal control system differs from one business organization to another depending on the nature and size of the business.

To achieve the objective of a business proper execution of business activities in the light of prevailing laws and socio-economic conditions of the country is called an internal control system or structure.

The internal control system is introduced to avoid errors and frauds and for systematic control of business activities.

Three elements of the internal control system are:

1. **Environment control:** The attitude, alertness, and work-zeal of directors, managers and shareholders are reflected through environmental control.

2. **Accounting system:** Accounting system means some procedures and recordings with which identification of business transactions, classification, summarization, statement preparation and analysis for timely presentation of correct information are performed.
3. **Control procedure:** The additional policies and procedures adopted by the business authority for ensuring the achievement of the specific goal of a business organization are the controlling procedures.

These control procedures are:

- Proper delegation of power,
- Segregation of responsibility,
- Preparation and use of documents,
- Adoption of adequate security measures to protect the properties, and
- Independent control over the execution of activities.

An internal control system, not only prevent fraud forgery but also fulfills other objects:

1. The business organization implements its policies complying with the prevailing laws of the country.
2. Employees and officers discharge their assigned responsibilities to increase efficiency in the execution of work.
3. Financial statements provide correct and reliable information maintaining proper accounts.

In light of the above discussion, it can be briefly stated that the overall policies and plans adopted by the management for the proper execution of business activities are called the internal control system.

5 Components of Internal Control System

Controlling the environment

The control environment is the basis of other elements of all other components of the internal control system. Moral values, managerial skills, the honesty of employees and managerial direction, etc. are included in the controlling environment.

Risk assessment

After setting up the objective of business, external and internal risks are to be assessed. The management determines risk controlling means after examining the risks related to every objective.

Control activities

The management establishes a controlling activities system to prevent risk associated with every objective. These controlling activities include all those measures that are to be followed by the employees.

Information and communication

Relevant information for taking decision are to be collected and reported in proper time. The events that yield data may originate from internal or external sources.

Communication is very important for achieving management goals. The employees are to realize what is expected of them and how their responsibilities are related to the activities of others. Communication of the owners with outside parties' like's suppliers is also very important.

Monitoring

When the internal control system is in practice, the organization monitors its effectiveness so that necessary changes can be brought if any serious problem arises.

Responsibility for Internal Control System

It is the general responsibility of all employees, officers, management of a company to follow the internal control system.

The under-mentioned three parties have definite roles to make internal control system effective:

Management

Establishment and maintenance of an effective internal control structure mainly depends on the management. Through leadership and example or meeting, the management demonstrates ethical behavior and integrity of character within the business.

Board of directors

The board of directors possessing a sound working knowledge gives directives to the management so that dishonest managers cannot ignore some control procedures. The board of directors stops this sort of unfair activity. Sometimes the efficient board of directors having access to the internal audit system can discover such fraud and forgery.

Auditors

The **auditors evaluate the effectiveness of the internal control structure of a business organization** and determine whether the business policies and activities are followed properly. The communication network helps an effective internal control structure in execution. And all officers and employees are part of this communication network.

3 Objectives of Internal Control System

Internal controls system includes a set of rules, policies, and procedures an organization implements to provide direction, increase efficiency and strengthen adherence to policies.

3 objectives of internal control are;

1. financial reports are reliable,
2. operations are effective and efficient, and
3. activities comply with applicable laws and regulations.

Characteristics of a Proper Internal Control System

An effective internal control system includes organizational planning of a business and adopts all work-system and process to fulfill the following targets:

1. Safeguarding business assets from stealing and wastage.
2. Ensuring compliance with business policies and the law of the land.
3. Evaluating functions of each employee and officer to increase efficiency in operation.
4. Ensuring true and reliable operating data and financial statements.

It is to be kept in mind, a business organization, be it's small or large, can enjoy the benefits of adopting an internal control system.

Prevention of stealing-plundering and wastage of assets is a part of the internal control system.

Protection of assets

A business organization protects its assets in the following ways:

Segregating the duties of the employees

Segregation of the duties of the employees means that each employee is assigned with specific tasks. The person in charge of assets is not allowed to maintain accounts of the assets.

Some other person maintains the accounts of these assets. Since different employees perform the same nature of transactions, the work of each is automatically checked. Segregation of the duties of the employees of an organization reduces the possibility of stealing assets and if stolen, detection becomes easier.

For example, there is no scope for stealing cash by a cash-receiving employee where cash receipts accounts are maintained by a different employee.

Assigning specific duties to each employee

The employee assigned with a specific duty is held responsible for his assigned activities. If and when any problem arises the manager can immediately identify the person concerned and holds him liable.

Lost documents can easily be detected if the task of maintaining records is assigned to a particular employee and it becomes possible to know the recording process of transactions.

An employee assigned with a particular job can easily provide necessary information regarding that job. Moreover, an employee feels proud if he is assigned a particular job and tries to complete the job using the best of his skill.

Rotating job assignments of the employees

Some organizations rotate job assignments of employees at intervals to avoid fraud-forgery by the employees concerned.

Under this policy, the employee concerned can easily understand that on the placement of somebody else in his place his dishonesty if it is done, will be detected. This ensures the honesty of an employee.

Using mechanical devices

Business concerns adopt various mechanical devices to avoid stealing, destruction, and wastage of assets. Under the mechanical system, cash register, cheque-protectors, time-clock, mechanical-counters, etc. are used as control methods.

Since a cash-register contains locking-tape, each cash sale is recorded here.

The amount of cheque is written on the cheque by the cheque-protector machine to avoid any sort of alteration.

Arrival and departure of employees are recorded properly with the help of time- clock.

Compliance with organization policies and laws of the country

Internal control becomes effective only when compliance with organization policies and laws of the country is ensured.

To make an internal control system effective and ensured, efficient and trustworthy employees are required to be appointed.

Effective starting of the internal control system depends on time and labor spent on the recruitment of employees.

There should be a training program for the newly appointed employees and policies of the business concerns are to be communicated to them properly.

For example,

Every cash disbursement must have prior approval of the higher authority.

Daily written job specification makes employees responsible for anti dutiful. 'Employees duties and execution of policies are to be well-defined to them during the primary training period.

In the case of the joint-stock company internal control system is to be framed complying with the law of the country.

Evaluation of performance

The proper controlling system should have provisions for supervision and evaluation of assigned duties of the employees. The absence of evaluation and supervision system hampers the objectives of a business organization to a great extent.

Many business organizations engage internal auditors to evaluate and supervise the work of the employees.

The **functions of internal auditors** are to evaluate and supervise the extent of policies and methods of the organization followed by the employees.

The accuracy of accounting records

A business organization should maintain a complete and correct accounting record.

For ensuring proper maintenance of accounts efficient and honest personnel are to be appointed and trained.

The performance of the employees is evaluated at intervals. By the supervisors to ensure that the policies of the business are followed by the employees.

An inaccurate or incomplete accounting record prompts the dishonest employees to steal because they can easily subside the act of stealing.

Transactions accounted for are the documentary evidence of business.

This documentary evidence is an integral part of internal control systems.

These documents are to be arranged serially for convenient control. Since these primary documents are the documentary evidence of transactions of a business, the validity of these documents is to be checked from time to time.

For example,

The documents used for recording transactions of accounts are examined for the re-audit purpose of the merchandise inventory of a business organization.

While maintaining accounts of transactions the accountant is to preserve the following four documents:

1. **Purchase requisition:** Written order placed by the officers of the department concerned to the purchasing department for purchasing a certain quantity of goods is called purchase requisition.
2. **Purchase order:** Before purchase, the buyer sends a written order to the seller requesting him to send particular goods. This written order is called a purchase order.
3. **Invoice/Chalan:** The seller sends an invoice with the sold goods to the buyer wherein the descriptions, quantity, rates of the goods are mentioned.
4. **Receiving report:** It is a purchase document prepared by an officer of the purchasing department. It is treated as documentary evidence of the goods received.

The flow of documentary evidence of business transactions and commodities is shown below by a diagram:

Steps:

1. Requisition department sends a purchase requisition to the purchasing department.
2. The purchasing department sends a purchase order to the supplier, with copies going to the receiving department and accounting department.
3. The supplier sends goods to the receiving department, where goods received are checked against the purchase order and send an invoice to the accounting department.
4. The receiving department sends goods to the requesting department and sends receiving a report to the accounting department.
5. Accounting department checks to receive reports against the purchase order and invoice and sends a cheque for payment of invoice to the supplier.

The price of purchased goods is paid on the basis of these four documents and these are compared with accounting records.

A business concern fails to make payment of a legitimate invoice without these documents or it might have to make payment of the fictitious invoice or more than one invoice.

A business concern effectively completes its internal control system comparing sources and documents with accounting records of those transactions.

It is unfortunate that a business concern adopting its internal control system cannot avoid theft altogether.

A dishonest employee always tries to misappropriate no matter whatever effective control systems exist as in a business concern.

Therefore, a business concern has to make an arrangement of casualty insurance on its assets. Under this system loss of non-cash assets is reimbursed.

Besides,

A business concern may arrange fidelity bonds between employees handling cash and other negotiable instruments. Under this system, a business concern will get reimbursement of money lost or theft.

Under these two systems i.e., casualty insurance on assets and fidelity bonds on employees, a business concern can recover at least a portion of any loss caused due to stealing, misappropriation, etc.

Q.5 Differentiate accounting from auditing. Describe the desired qualities of an auditor.

Accountancy begins where book-keeping ends. It means, accountant comes with the picture where book-keeper has done his job. The accountant performs the following functions:

1. Checking the work of the book-keeper,
2. Preparation of trial balance,
3. Preparation of financial statements e.g. Profit & Loss account and Balance Sheet,
4. Passing ratification entries and making necessary adjustments.

Thus, accountancy is concerned with classification and summarization of financial records and it is semi-analytical in nature. Its main object is to compile and analyse the business records. The accountant may or may not be an employee of the business. He has knowledge of book-keeping and accounting principal and practices. Auditing is a critical and detailed examination of the accounts prepared by others. Auditing begins where accounting ends”. Auditing is a fact-finding technique. The auditor checks the truthfulness of accounts by verifying and vouching the entries passed by the accountant and final accounts prepared by him Auditing is therefore, the securing of accounts of a business, with the help of vouchers, documents, and the information given and explanation submitted to him. Unlike an accountant.

The word audit is derived from the Latin word “AUDIRE” which means to hear. Initially auditor was a person appointed by the owners to check account whenever the suspected fraud, he was to hear explanation given by the person responsible for financial transactions. Emergence of joint stock companies changed the approach of auditing as ownership was pestered from management. The emphasis now is clearly on the verification of accounting data with a view on the reliability of accounting statement.

In the words of Spicer and Pegler, “An audit is such an examination of the books, accounts and vouchers of a business as it enable the auditor to satisfy that the Balance Sheets is properly drawn up, so as to give a true and fair view of the state of the affairs of the business and whether the profit and loss accounts gives a true and fair view of the profit or loss for the financial period according to the best of his information and explanations given to him and as shown by the books, and if not, in what respects he is not satisfied”.

In the words of **Montgomery**, “Auditing is a systematic examination of the books and records of a business or other organization, in order to ascertain or verify and report upon the facts regarding its financial operation and the result thereof”.

In the words of **Lawrence R. Dicksee**, “An audit is an examination of records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they relate. In some circumstances it may be necessary to ascertain whether the transactions are supported by authority.

In the words **A.W. Hanson**, "An audit is an examination of such records to establish their reliability and the reliability of statement drawn from them".

In the words of **R.B. Bose**, "Audit may be said to the verification of the accuracy and correctness of the books of accounts by independent person qualified for the job and not in any way connected with the preparation of such accounts".

The main purpose of Auditing or object is to find the opinion of an auditor about the correctness and reliability of accounts and the financial position of the business concern. For this purpose auditor has to check the arithmetical accuracy of the books of account and to find out that whether the transactions entered in the books of account are correct or incorrect. This is done by various methods like inspecting comparing and checking. So all that work that is done by the auditor ensures him that figures are facts.

From the above definitions it is clear that the auditor's basic duty is to examine the accounts and its arithmetical accuracy. He must ensure than the financial statements depicts true and fair view of the state of affairs of the business. Since, Auditing is a full and critical examination of the books of accounts to find out their accuracy. That is why it is said that auditing begins where accounting ends.

Difference between Accounting and Auditing

- 1. Scope:** Accounting is concerned with preparing of financial statements. Auditing is concerned with checking of financial statements.
- 2. Purpose:** The purpose of accounting is to show the performance and financial statement. The purpose of auditing is to certify the true and fair view of financial statement.
- 3. Nature:** Accounting is concerned with current data. It constructive in nature. Auditing is concern with past data. It is analytical nature.
- 4. Knowledge:** Accounting works requires that accountant must have accounting knowledge. Auditing work required that an auditor must have accounting as well as auditing knowledge.
- 5. Status:** The accountant is permanent employee of the business. The auditor is an independent person.
- 6. Start:** The work of an accountant starts when the work of bookkeeper ends. The work of an auditor starts hen the work of an accountant ends.
- 7. Qualification:** An accountant may not be a Chartered Accountant as per law. An auditor must be Chartered Accountant for public companies.
- 8. Principles:** The accounting principles include going concern accrual consistency and prudence. The auditing principles include independence, objectivity, full disclosure and materiality.
- 9. Methods:** The accounting methods include depreciation, amortization and valuation. The auditing method include manual and computerized.
- 10. Techniques:** Accounting technique includes depreciation rate interest rate and installment payment. Auditing technique include vouching, verification and valuation.

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11. Rules: Accounting is not governed by any code of conduct laid down by any institute. Auditing is governed by code of conduct as laid down by institute of chartered accountants.

12. Necessity: Accounting is necessity of every business entity whether small or large. Auditing is not necessity of every business.

13. Report: The accounting work requires no report to any party. The auditing work requires separate report to shareholders director or owners.