



**Discipline Courses-I**

**Semester-I**

**Paper: I**

**Unit-VIII**

**Lesson: Auditing Process and Vouching**

**Lesson Developer: Rati Dhillon**

**College/Department: Bharati College, University of Delhi**

## **Lesson 2 Audit Process and Vouching**

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### **1. Learning Outcomes:**

After you have read this lesson, you should be able to:

- understand the process of financial audit for an organization,
- understand the theoretical structure of auditing and appreciate its relevance,
- differentiate between internal check, internal control and internal audit,
- comprehend the meaning of vouching and its relevance in the audit process,
- describe the procedure of vouching different types of items appearing in financial statements.

## 2. Introduction:

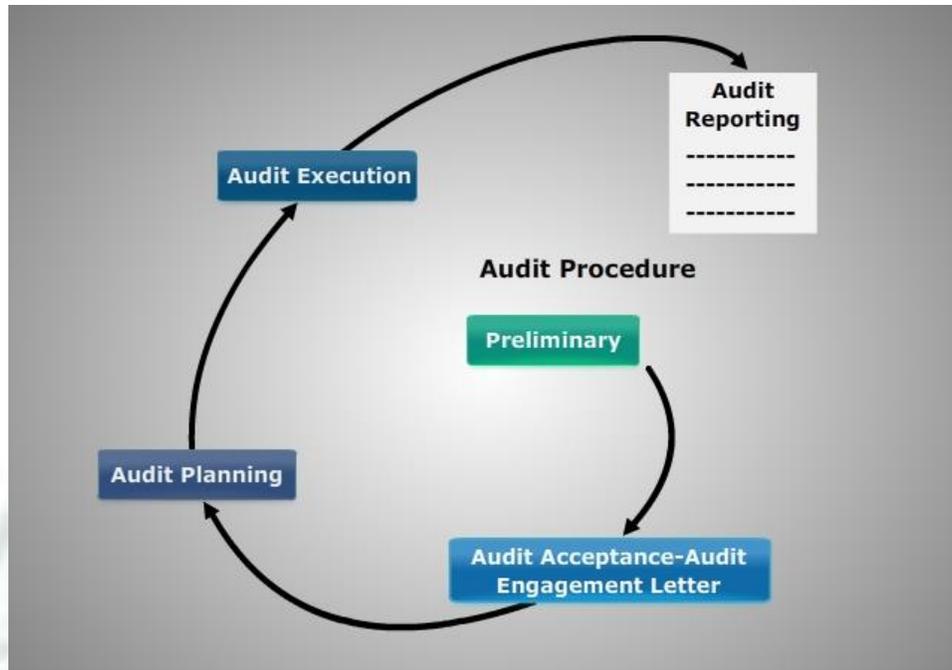
An audit is a dynamic process that involves personal skill and competence to carry out examination of financial statements in order to ascertain its truth and fairness. This lesson focuses on the comprehensive study of entire audit process carried out in different stages along with fundamental/ theoretical framework on which audit standards are based. Just like any process that may be described as a sequential course of action chosen to attain certain specific objectives, an audit process may be described as a set of procedures adopted in order to check the accuracy, validity and authenticity of financial statements. In the process of auditing, one very important aspect is vouching. The lesson describes the concept of vouching and how the items in financial statements are vouched.

## 3. Audit Process

The process of auditing begins with some preliminary activities to be undertaken by the prospective auditor in order to ascertain whether to accept or reject an audit assignment, followed by some activities to be taken up after accepting the engagement but before commencing the audit. Once the scope of work and other things are agreed upon, the auditor plans the process of audit. While the basic audit process remains the same, yet planning the sequence of different procedures to ensure that there is not too much interference in the smooth functioning of the enterprise has to be chalked out. Once a detailed plan has been devised, it is executed and finally a report is drawn up based on the findings. The figure below summarizes the complete audit process that involves five broad stages.

Figure 1: Process of Audit

## Audit Process and Vouching



### Value Addition 1: Image

#### Audit Process of a Cooperative Society

Click on the link below to view an image on the audit process of a cooperative society by either government auditors, or certified auditors appointed by the registrar, or by a chartered accountant.

Source: <http://sahakarayukta.maharashtra.gov.in/SITE/Graphics/Images/AuditProcess.png>

### 1. Preliminary Activities

As a preliminary task, before commencing with the audit, the auditor must consider the following points:

1. Before accepting any audit work, it is the responsibility of the auditor to get basic knowledge about the prospective client and his business.
2. Before accepting an audit assignment, the auditor should always communicate with the previous auditor or the retiring auditor to know any special aspects of the business and reasons for not joining the company again.
3. The nature to be done and the scope of work should be determined in the beginning itself.
4. The auditor should conduct a detailed study to get information about the organization, its activities and services, its organization structure and the extent of authority and responsibility of each member in the organization.
5. Before commencement, auditor should look into the internal control system of the organization to gain an idea about the degree of reliability on the books of accounts.
6. One of the fundamental principles prevailing in auditing is that an auditor is permitted to rely on work performed by others, provided he exercises ample skill and care and does not have any reason to doubt he reliance on such work. It is therefore very much necessary for an auditor to look carefully into the internal audit and internal control system.

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7. It is also recommended that an auditor should look into the prospective client's previous year's accounts and audit report. This not only helps an auditor to know more about the company, but also points out special areas which require care and due attention.
8. After considering the above points, an audit program must be framed by him.

### 2. Acceptance of Engagement Letter

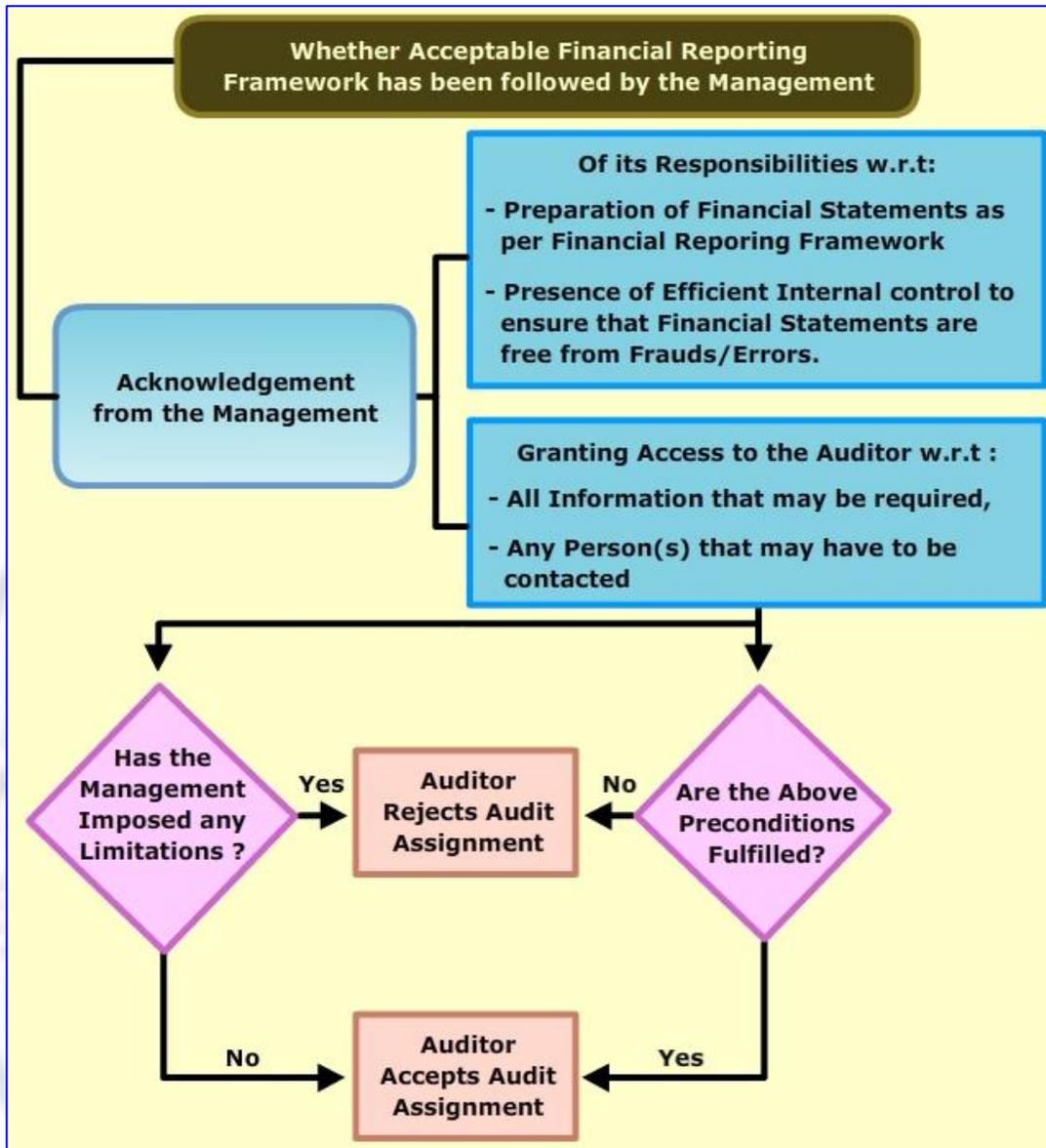
After studying and satisfying client's profile, the auditor should send an engagement letter before commencement of audit. An engagement letter is an official confirmation from the auditor with regard to acceptance of appointment as auditor, and it includes the objectives and scope of audit and extent of auditors' responsibilities.

The figure below gives summarizes SA-210 and shows how the terms of Audit Engagement are agreed upon.

Figure 2: Acceptance or Rejection Engagement Letter



## Audit Process and Vouching



### SA-210 on Recurring Audit-

Before completing audit, if the client requests the auditor to change the terms that conveys lower assurance, it should be considered by the auditor on the basis whether there is a reasonable justification to change. If the answer is yes, then the new terms may be agreed. But if the answer is no, that is, then the new terms must not be accepted. In some cases the management may exert undue pressure on the auditors for accepting the new terms that they may not find justified. In such a case, the auditors must withdraw from the audit assignment and must communicate the same to the management.

### Additional Considerations

When financial reporting standards are in conflict with law, auditor should discuss this with the management. If additional disclosure in financial statements or amendment to standard is possible, then it may be allowed, otherwise the auditor should modify report regarding this. Also, if the format of audit report under

## Audit Process and Vouching

governing statute is different that in SA, then additional explanation in audit report is required.

<b>Value Addition 2: Example</b>
<b>Audit Engagement Letter</b>
Click on the link below to open a word document that shows a sample audit engagement letter covering aspects like agreed upon responsibility of management and auditors, scope of audit, timeline for audit process and auditor's fees.
Source: <a href="http://sahakarayukta.maharashtra.gov.in/SITE/Graphics/Images/AuditProcess.png">http://sahakarayukta.maharashtra.gov.in/SITE/Graphics/Images/AuditProcess.png</a> <a href="http://www.google.co.in/url?sa=t&amp;rct=j&amp;q=&amp;esrc=s&amp;source=web&amp;cd=3&amp;ved=0CDcQFjAC&amp;url=http%3A%2F%2Fwww.edb.gov.hk%2Fattachment%2Fen%2Fsch-admin%2Fsbm%2Fcorner-imc-sch%2Fsample%2520audit%2520engagement%2520letter.doc&amp;ei=W9cmUubdMYWQrQfW74CoBw&amp;usg=AFQjCNF1si0E2T-WF3DEwG_0q3sh2c0o7A&amp;bvm=bv.51495398,d.bmk">http://www.google.co.in/url?sa=t&amp;rct=j&amp;q=&amp;esrc=s&amp;source=web&amp;cd=3&amp;ved=0CDcQFjAC&amp;url=http%3A%2F%2Fwww.edb.gov.hk%2Fattachment%2Fen%2Fsch-admin%2Fsbm%2Fcorner-imc-sch%2Fsample%2520audit%2520engagement%2520letter.doc&amp;ei=W9cmUubdMYWQrQfW74CoBw&amp;usg=AFQjCNF1si0E2T-WF3DEwG_0q3sh2c0o7A&amp;bvm=bv.51495398,d.bmk</a>

### 3. Audit Planning

There are some universal principles of management that are applicable in all fields and to auditing too. One such principle is planning. Planning is essential for every activity. Planning forms the very basis of our framework of work. Execution without planning is inefficient and planning without execution leads to wastage of resources. Thus, for successful execution of audit, it is necessary to plan an audit carefully.

According to SA 300 ( earlier AAS-8): "Audit planning refers to the planning by the auditor made to enable him to conduct an effective audit in an efficient and timely manner."

Thus, we can say that audit planning means developing of overall plan regarding the procedures, scope and conduct of an effective audit.

#### **Audit Programme**

Audit programme refers to auditor's plan of action. It is detailed plan of work prepared by the auditor, which consists of a set of techniques and procedures that the auditor will apply. It also lists the scope of activities to be undertaken, thereby giving basis for supervision and control of audit work. It clearly states the persons responsible for different tasks along with the time duration within which work is to be completed.

"Audit programme is a flexibly planned procedure of examination." - A. W. Holmes

"An audit programme is a detailed plan of auditing work to be performed specifying the procedures to be followed in verification of each item in the financial statements and giving the estimated time required." - Prof. Meig

**Advantages of Audit Programme** – An audit programme makes the task of the auditor highly systematic and achievable in the given time frame. It offers a number of other benefits that are described below.

1. Selection of assistants- The audit programme helps in selecting assistants as per their capability.
2. Instructions for staff- It contains instructions for staff as to work to be done.
3. Ready check list- It provides a ready checklist of all the procedures and techniques to be adopted.

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4. No ignorance or overlooking- With a properly written programme, there is no chance of forgetting or overlooking some important matter.
5. Responsibility fixation- An audit programme clearly sets out the duties of all the individuals, thus enabling the fixation of responsibility and accountability.
6. Progress of work done- The progress of work can be determined on the basis of entries on the program.
7. Supervision- Work by assistants can be easily supervised by referring to the programme.
8. Timely completion- Time to time compliance with the programme is checked so as to complete the work on timely basis.
9. Basis for reporting- Audit programme easily sets out the procedures-evidence-conclusion chain that enables the auditor to express an opinion.
10. Future audits- It serves as a guide for audits to be carried out in the succeeding years.
11. Serves as an evidence - In case, auditor faces some case for negligence, he can defend himself by showing audit program.

<b>Value Addition 3: Example</b>
<b>Audit Programme</b>
Click on the link below to see a sample of audit programme for separate items like, account receivables, cash, equity, income statement, income taxes, inventory, investments, etc. and a consolidated audit programme for all items.
Source: <a href="http://www.oglethorpe.edu/faculty/~c_benton/auditing/sample_audits_programs.html">http://www.oglethorpe.edu/faculty/~c_benton/auditing/sample_audits_programs.html</a>

**Limitations of Audit Programme** - No procedure is perfect and no program is foolproof to cover all aspects and be cent percent effective. An audit program suffers from certain limitations that are listed below. However, it must be remembered that these limitations do not diminish the relevance of audit programme in any way. These are only be taken as cautionary reminders by the auditors.

1. Mechanical approach- Assistants may carry out work mechanically without understanding the whole concept.
2. Inflexibility- The programme often becomes rigid and inflexible. Assistants are not able to change it as per requirements of specific case.
3. Lack of initiative- Hard and fast programme hurts the initiatives and judgmental skills of hardworking assistants.
4. Monotonous- Talented and efficient staff becomes frustrated due to repetitiveness in programs.
5. Shelter for inefficient assistants- Often the non-enterprising employees think that the audit programme is exhaustive in nature. They don't even think of any unusual matter, which is not listed in program, even if its presence can change the audit approach.

<b>Value Addition 4: Surf and Learn</b>
<b>Audit Planning</b>
Click on the link below to Auditing and Assurance Standard (AAS) 8 – Audit Planning
Source: <a href="http://www.caalley.com/aas/aas08.html">http://www.caalley.com/aas/aas08.html</a>

### 4. Audit Execution

## Audit Process and Vouching

Audit execution refers to actual implementation of the audit plan and the audit program. Audit execution involves undertaking the following steps:

- Critical examination and review of accounting and internal control system.
- Checking all transactions in regard to their proper recording in books of accounts as per the required standards.
- Determining the degree of accuracy, authenticity and validity of such transactions.
- Determining the authenticity of assertions to rule out the cases involving misrepresentation and fraud.
- Examining of statements to check that the company has complied with all the relevant laws and other legal requirements wherever applicable.
- Verification, checking and vouching of financial statements.

**5. Auditor's Report** – An auditor's report contains the opinion of the auditor(s) about the true and fair view of the financial statements. It also includes remarks of the auditor at appropriate places, if required; and disclosure of comments if any. Such a report is duly signed by the auditor and submitted to the client or the appropriate authority.

The process of audit, as described above covers these five dimensions, namely, preliminary work, audit engagement, audit planning, audit execution and audit report. These may be called by other related terms, or a particular aspect may be further split into stages and listed in the process. Also, not only in the case of a financial audit, the audit process by and large remains same in case of other audits as well.

<b>Value Addition 5: Image</b>
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<b>IT Audit Process</b>
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Click on the link below to view an image on IT audit process.
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Source: <a href="http://www.luminusconsult.com/wp-content/uploads/2012/05/itaudit.png">http://www.luminusconsult.com/wp-content/uploads/2012/05/itaudit.png</a>
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<b>Value Addition 6: Image</b>
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<b>Process of Auditing</b>
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Click on the link below to view an image on process of financial auditing that describes the auditing process in five stages and outlines the tasks undertaken by the auditors in each phase and corresponding benefits accruing to the clients.
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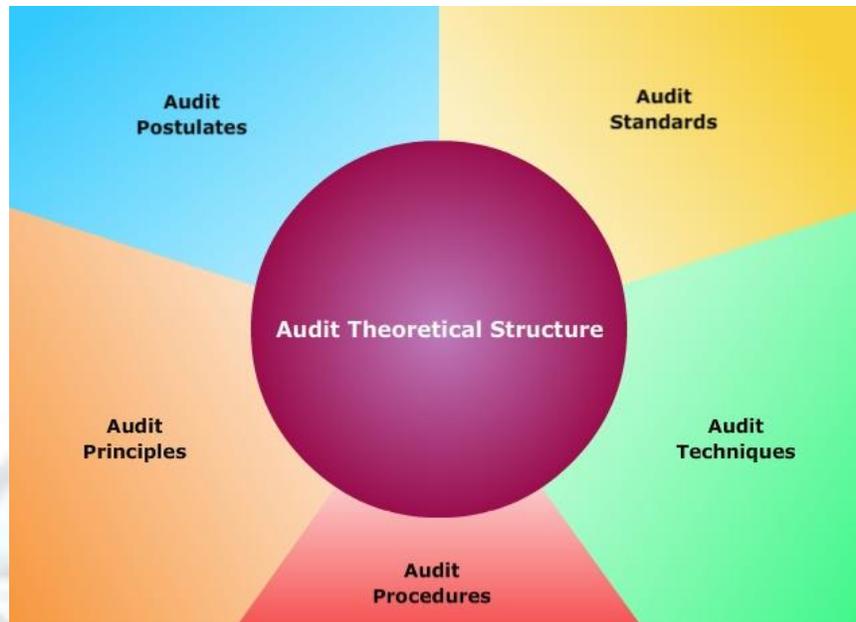
Source: <a href="http://www.gt.com.zm/UserFiles/Image/approach.jpg">http://www.gt.com.zm/UserFiles/Image/approach.jpg</a>
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## 4. Audit Theoretical Structure

Audit is a very dynamic field, which requires a comprehensive knowledge. To study and understand an audit process correctly, it is required to study the main elements or structure of its framework. These are depicted in the figure below.

Figure 3: Audit Theoretical Structure

# Audit Process and Vouching



## 1. Audit Postulates

Postulates are referred to as basic truths and assumptions, which require no evidence or proof to be accepted. Mautz and Sharaf have identified basic postulate in their work, "The Philosophy of Auditing". They are listed as under:

1. Financial statements and financial data are supportable.
2. There is no necessary divergence of interest amongst the auditors and the management of the company under audit.
3. The financial statements and other information submitted for authentication are free from collusive and other unusual audit.
4. The presence of an acceptable system of internal control eliminates the chances of irregularities.
5. Regular appliance of Generally Accepted Accounting Principles (GAAP) results in the fair presentation of financial position and results of operations.
6. In the lack of clear evidence to the contrary, what has held true in the past for the enterprise under examination, will hold true in future.
7. When examining financial data for the purpose of expressing an independent opinion thereon, the auditors act exclusively in the capacity of auditor.
8. The professional status of the independent auditor imposes commensurate professional obligations.

## 2. Audit Principles

Principles are those statements or basic rules of activities that are regarded as truths necessary to achieve audit objectives. SA-200 (earlier AAS-1) describes the basic principles governing an audit as:

1. Integrity, objectivity and independence - This principle states that an auditor should carry out his work honestly without partiality or bias, and should not have any personal interest in the client's business.
2. Confidentiality- An auditor should maintain strict confidentiality of his client's business and information accessed by him. He is required not to disclose vital information to anybody unless and until it is required as per the duty of law.

## Audit Process and Vouching

3. Skill and competence- To perform an audit it is required that the person who is conducting it is skilled and competent to do it. Auditing involves a deep analysis and critical review of the financial statements. To understand the intricacies of financial statement, it is required that an auditor should have full knowledge for forming his opinion.
4. Work performed by others- An auditor cannot perform all the work by himself. He requires the help of his assistants or other people who perform work. But the sole responsibility of relying on work performed by others remains on the auditor and thus the auditor should take due care before relying on such sources.
5. Audit documentation - Auditor should maintain written records, called working papers, of all the activities carried out by him. Such records can be used as evidence for supporting his opinion in auditor's report.
6. Audit planning – Before taking up a new audit, an auditor should plan out his work so as to achieve its audit objectives efficiently and in time.
7. Audit evidence- SA-500 deals with audit evidence. In order to express his opinion an auditor needs substantiate evidence. The evidence so obtained should be appropriate and valid in order to support a financial statement.
8. Accounting system and internal control- An auditor, before commencing his work, should see the type of accounting system followed by the enterprise and should assess the degree of reliability on the internal control of the organization.
9. Audit conclusion and reporting- An audit is not completed if it is not supported by a report. A report contains auditor's opinion regarding the true and fair view of the financial statements.

### 3. Auditing Standards

Auditing standards are the general principles and guidelines of audit, which are required to be followed and referred to by auditors while doing work. Following auditing standards leads to maintenance of uniformity among different companies as regards to procedures and principles. In India, Audit Assurance Standards (AAS) are issued by ICAI. In order to work on the pattern of International Standards, the auditing standards are now called Standards of Auditing (SA).

Table 1: Overview of Auditing Standards (SA) with Previous AAS Numbers

New SA	Old AAS	Title of standard
SQC 1		Quality control for firms that perform audit and reviews of historical financial information, and other Assurance and related service engagements
SA 200	AAS01	Overall objectives of the independent auditor and conduct of an audit in accordance with standards of auditing
SA210	AAS26	Agreeing the terms of audit engagements
SA220	AAS17	Quality control for an audit of financial statements
SA230	AAS03	Audit documentation
SA240	AAS04	The auditors responsibilities relating to fraud in an audit of financial statements
SA250	AAS21	The auditors responsibilities relating to laws and regulation in an audit of financial statements
SA260	AAS27	Communication with those charged with governance
SA265		Communicating deficiencies in Internal control to those charged with governance and management

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<b>SA299</b>	AAS12	Responsibility of joint auditors
<b>SA300</b>	AAS08	Planning an audit of financial statements
<b>SA315</b>		Identifying and assessing the risks of material misstatement through understanding the entity and its environment.
<b>SA320</b>	AAS13	Materiality in planning and performing an audit
<b>SA330</b>		The auditor's response to assessed risks
<b>SA400</b>	AAS06	Risk assessment and internal control
<b>SA402</b>	AAS24	Audit considerations relating to an entity using service organization
<b>SA450</b>		Evaluation of misstatements identified during the audit
<b>SA500</b>	AAS05	Audit evidence
<b>SA501</b>	AAS34	Audit evidence –specific considerations for selected items
<b>SA505</b>	AAS30	External confirmations
<b>SA510</b>	AAS22	Initial audit engagements-opening balances
<b>SA520</b>	AAS14	Analytical procedures
<b>SA530</b>	AAS15	Audit sampling
<b>SA540</b>	AAS18	Auditing accounting estimates, including fair value accounting estimates and related disclosures.
<b>SA550</b>	AAS23	Related parties
<b>SA560</b>	AAS19	Subsequent events
<b>SA570</b>	AAS16	Going concern
<b>SA580</b>	AAS11	Written representations
<b>SA600</b>	AAS10	Using work of another auditor
<b>SA610</b>	AAS07	Using work of internal auditor
<b>SA620</b>	AAS09	Using work of an auditor's expert
<b>SA700</b>	AAS28	Forming opinion and reporting on financial statements
<b>SA710</b>	AAS25	Comparative information-corresponding figures and comparative financial statements
<b>SA720</b>	AAS25	The auditor's responsibility in relation to other information in documents containing audited financial statements
<b>SA705</b>	AAS28	Modification to the opinion in the independent auditor's report
<b>SA706</b>	AAS28	Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report
<b>SA800</b>		Special considerations- audit of financial statements prepared in accordance with special purpose framework
<b>SA805</b>		Special considerations-audits of single purpose financial statements and specific elements, accounts or items of a financial statement
<b>SA810</b>		Engagements to report on summary financial statements
<b>SRE2400</b>	AAS33	Engagements to review financial statements
<b>SRE2410</b>		Review of interim financial information performed by the independent auditor of the entity
<b>SAE3400</b>	AAS35	The examination of prospective financial information
<b>SRS4410</b>	AAS31	Engagements to compile financial information
<b>SRS4400</b>	AAS32	Engagements to perform agreed upon procedures regarding financial information
<b>Source</b>		Singh, A.K. and Gupta, Lovleen, principles of auditing, Mayur paperbacks, New Delhi.pp 191- 192.

### 4. Audit Procedures

## Audit Process and Vouching

Procedure means a way of doing things to get the desired results in an efficient way. Audit procedure comprises of number of techniques relating to the manner of handling audit work. It describes various techniques on how an item should be studied. These have been specified according to SA-500 (earlier AAS-5) on audit evidence.

Audit procedures can be divided into two broad categories:

1. Compliance procedure - These tests are done to make sure that an auditor can rely on internal control and on the work performed by others. The auditor tests to find out the following:
  - that the internal control is present and it operates efficiently, and internal control was exercised in the period for which an audit is being conducted.
  - the basic elements that are checked are regarding compliance of internal control system with regard to its existence, effectiveness and continuity.
2. Substantive procedure- These audit tests are so devised to obtain evidence to confirm the assertion made in the books of accounts and financial statements. They aim to find out existence of an asset, rights and obligations on assets, occurrence of transactions, completeness of transactions, correct valuation of assets and liabilities, proper presentation and disclosure of items in financial statements. Substantive procedures can be of two types:-
  - a) Tests of detail- These tests include tests of details of transactions and tests of details of balances. The tests of details of transactions relate to vouching, casting, checking of postings, balancing etc., and the tests of details of balances relate to verification, physical examination and confirmation.
  - b) Analytical procedures - Analyzing ratio and trends, comparison of entity information with results of prior periods or anticipated results.

### 5. Audit Techniques

Techniques are the methods applied in carrying out audit procedures in order to attain the audit objective. Some important techniques of auditing are examination of records, inquiry, sampling, confirmation, compliance, compliance tests, use of computer techniques, substantive tests, dependence on experts, analytical reviews, etc. Audit techniques may be applied to the entire data collected or gathered by the auditors, or it may be applied to a selected set of representative data and the conclusions drawn from there may be extended to the entire data. It is necessary here to distinguish between routine checking and test checking.

Routine checking - Routine checking aims to obtain arithmetical correctness of transactions. It includes checking of casting of journal and ledgers, carry forward of balances, trial balance drawing up, examination of balance sheet and profit & loss account, posting entries, and balancing of ledger accounts.

Test checking - Prof Meig defines test checking as, "Means to select and examine a representative sample from a large number of similar items." Test checking means examining less than cent percent of the items in the population. The auditor usually does not have enough time for detailed examinations of all items. Number of transactions in the balance sheet are generally very large. Most of the items are similar in nature. On the basis of compliance procedures, if it is concluded that internal control system is effective, there is no need for a cent percent detailed examination. However, care should be taken before applying test checking and the following points may be considered:

1. A thorough study of accounting system must be conducted.

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2. A thorough study of internal control system must be carried out.
3. The areas that are not suitable for sampling must be excluded.
4. Proper planning must be ensured.
5. Sample size must be determined appropriately .
6. It must be ensured that there is no bias.

### 5. Internal Control, Internal Check, and Internal Audit

All the three terms, internal control, internal check and internal audit are inter-related to each other. While internal control is a management function, internal check is a tool or a technique to facilitate internal control, and internal audit is the mechanism that ensures that internal control is in place.

**1. Internal control** – Internal control is a management function. It refers to a system of control for the entire company that is established by the management in order to achieve its objectives effectively and efficiently. The main focus of internal control is to safeguard company's assets, maintenance of accuracy in records and ensuring the adherence to the management policy and rules. It includes accounting control, control over environment of organization, control of procedures of company and supervisory control.

**2. Internal check** – It is a tool of internal control. It refers to arranging of the duties and work of staff in such a way that the work performed by one person moves forward to the other for a sequential processing in its normal course and is thus automatically checked by another, thereby reducing the probability of errors and frauds.

According to Spicer and Pegler- "A system of internal check is an arrangement of staff duties whereby no one person is allowed to carry through and to record every aspect of the transaction, so that without collusion between two or more persons, fraud is prevented and at the same time the possibilities of errors are reduced to the minimum."

**3. Internal audit**- According to Howard F. Stettler: - "Internal audit is the audit of company affairs and activities from within." Institute of Internal Auditors, USA defines internal audit as: "Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The purpose is to assist members of the organization in the effective discharge of their responsibilities. Thus, internal auditing furnishes them with analysis, appraisals, recommendations, counsel and information concerning the activities reviewed."

<b>Value Addition 7: Image</b>
<b>Internal Auditor's Role</b>
Click on the link below to view an image on the stages of audit process and the management's role and internal auditor's role corresponding to these stages.
Source: <a href="http://www.executiveboard.com/blogs/uploads_views/2010/04/Role-Distinctions-for-the-New-IA-Function1.jpg">http://www.executiveboard.com/blogs/uploads_views/2010/04/Role-Distinctions-for-the-New-IA-Function1.jpg</a>

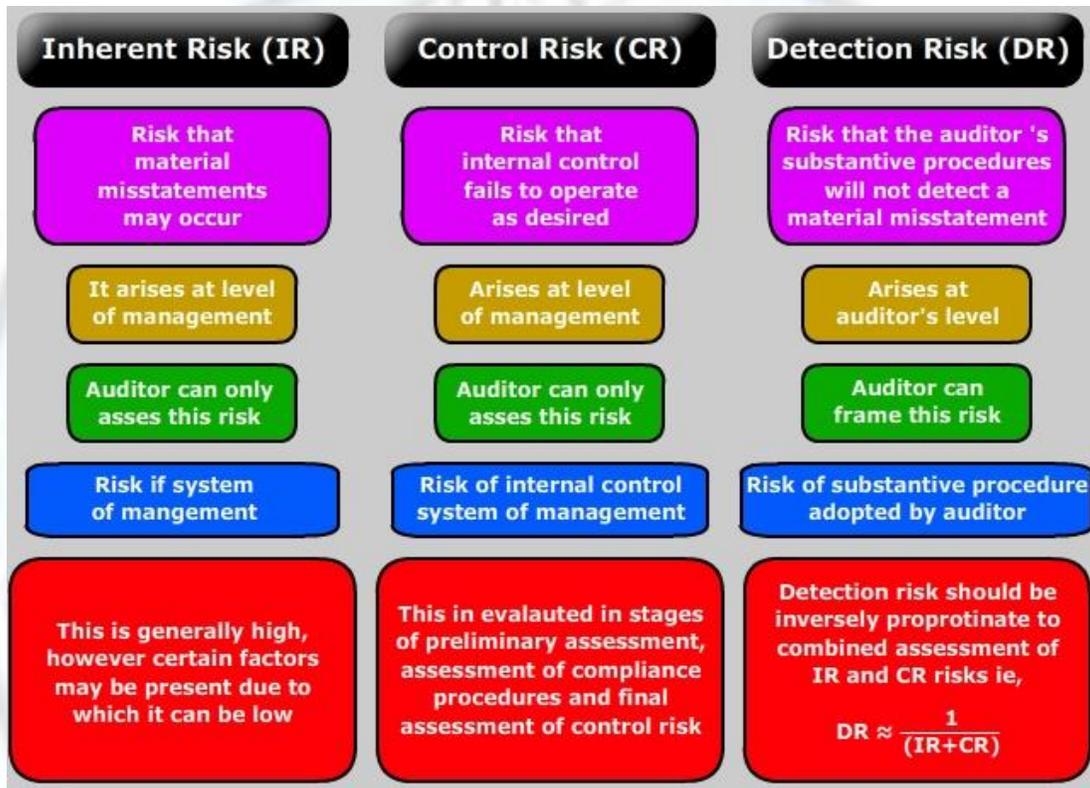
### 6. Audit Risk

Audit risk is the risk that the auditor may give an inappropriate opinion when the financial statements are materially misstated. Audit risk is also termed as residual risk and is composed of three components; inherent risk, control risk, and detection risk. Audit risk may be computed by multiplying these risks after they have been calculating separately.

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Inherent risk, as the name suggests refers to the risk inherent in the nature of the transactions itself. For example, inherent risk in case of cash transactions is higher than the inherent risk of transactions done through bank. Control risk pertains to the risk in the internal control mechanism. It may be possible that certain misappropriations, errors or frauds may get overlooked even when a strong and efficient internal control is in place. Detection risk is the risk of failing to detect an error or fraud on the part of the auditor due to negligence, or human error or due to a wrong sample chosen or inappropriate technique adopted in the process of vouching or verification.

Figure 4: Components of Audit Risk



In other words, it can be stated that audit risk revolves around three aspects, which are accounting framework, audit framework and client-management agreement with respect to the scope of audit that varies in the case of a general purpose audit and a special purpose audit. The accounting framework covers risks of non-compliance with Company's Act or other Acts that are applicable, accounting standards, and the Generally Accepted Accounting Principles. The Audit Framework covers risks due to non-compliance with the Standard Auditing Practices and audit procedures. This is summarized in the figure below.

Figure 5: Audit Risk

## Audit Process and Vouching



### Value Addition 8: Did You Know?

#### Audit Process and Audit Risk

Click on the link below to view an image that describes three important elements that effect an audit process, namely, Accountability framework, Audit framework, and Audit-Client assertions, and audit risk that is at the heart of the audit process.

Source: <http://www.audit.tas.gov.au/aboutus/auditprocess.html>

## 7. Vouching

A voucher is a documentary evidence of a financial transaction that contains the details such as the date of the financial transaction as well as the amount involved in the financial transaction. Vouching may be termed as the process of substantiating the financial transactions with their supportive documentary vouchers to ensure that the entries were recorded correctly under correct heads and accounts, with the right amounts, and on the correct side of the account. It also ensures that the entries recorded pertain to the financial year under audit and pertain to business transactions. It is important for the auditor to satisfy himself that the transactions so recorded are not fictitious ones to window dress the accounts; they are not personal transactions of any director, manager or employee; and that they were suitably authorized and approved by the concerned authorities.

The process of vouching is defined by different authors as follows:

"The examination of documentary evidence in support of entries is often referred to as vouching."  
- R.K Mautz

"Vouching consists of comparing entries in the books of accounts with documentary evidence in support thereto."  
- L.R Dicksee

"Vouching does not mean merely the inspection of receipts with the cash book, but includes the examination of the transactions of a business, together with documentary and other evidence of sufficient validity to satisfy an auditor that such transactions are in order; have been properly authorized and are correctly recorded in the books."  
- F. R. M. De Paula

## Audit Process and Vouching

“The examination by the auditor of all documentary evidence, which is available to support the authenticity of the transactions entered in clients records.” - Spicer and Pegler

### 7.1 Objectives of Vouching

From the above definitions, the primary objectives of vouching may be listed as follows:

1. To analyze and examine that all the entries are properly recorded and accounted for in the books of accounts.
2. To make sure that sufficient documentary evidence exists to support a transaction.
3. To ensure that all the transactions and entries in consideration are related to the business and time period under audit.
4. To critically evaluate the collected evidences.
5. To ensure that the transactions are duly authenticated by a responsible person.

Thus, we can say that vouching is important because it serves as a basis for formulation of an opinion about truthfulness and fairness of financial statements, helps in detecting and preventing frauds and errors, leads to successful conduct and completion of audit work.

### 7.2 Principles of Vouching

There are certain principles of vouching that may be described as the rules to be adopted or points to be considered by the auditor while conducting the process of vouching the transactions. These generally agreed upon principles are listed below:

1. All the vouchers should be serially numbered and chronologically arranged according to the date of occurrence of the transactions.
2. The dates of vouchers should match with the dates of entry in books of accounts.
3. Those vouchers that are checked should be duly marked, so as to avoid production of the same voucher to support another entry.
4. If the examined vouchers are prepared in duplicate, such vouchers should be thoroughly checked, as sometimes it reflects fraud on the part of the company.
5. The vouchers should be adequately stamped in case it is of an amount of Rs. 5000 or above.
6. Vouchers should also be evaluated to see that they are addressed to the client and relate to the business of the concerned organization.
7. It should be clearly examined that the amount written in words and numbers match.
8. The signature of the official who has been authorized to approve the transactions should be there on the vouchers.
9. The auditor should not seek help of the client’s staff while vouching.

## 8. Vouching\_of Various Items

Different items call for different method of vouching. The documents or vouchers to be checked, or the supporting evidence that needs to be examined for different transactions vary. The following table provides the vouchers that need to be examined by the auditor for vouching of specific items.

Table 2: Required Evidence in case of Vouching of Specific Items.

**(Interactive)** Table 2:- Click on the Items to View the Vouchers that need to be examined in the Gray Box.

## Audit Process and Vouching

S.no	Items	Supporting Evidences and Vouchers to be Checked
1	Cash sales	Duplicate copy of cash memo, cashier's summary, salesman's summaries, gatekeeper's goods delivered summary.
2	Credit sales	Purchase orders, sales invoice, copies of transporter's receipt, goods outward register, and summary statement of customer's account.
3	Sales return	Sales return book, credit notes issues/ debit notes received, goods inward register, statement of customer's account.
4	Cash receipts from debtors	Counterfoils of receipts issued, statement of customer's account or correspondence with customers.
5	receipts form hire purchase	Hire purchase agreement, counterfoils of receipts issued.
6	Sale of investments	Broker's contract note, investment register
7	Rent received	Rent agreement/lease deed, counter foil of rent receipts, rent register, correspondence with tenant.
8	Insurance claims	Insurance policies, copy of claims lodged, correspondence with insurance company, counter foil of cash receipt.
9	Income from investment A ) interest on bank deposit  B) interest on loan granted  C) interest of securities ( eg., Debentures)  D) Dividend Income	Bank pass book, fixed deposit receipts, counter foil of interest warrant.  Loan agreement, counterfoil of receipt issued.  Cash book, interest warrant, covering letters, and tax deduction certificate.  Cash book/pass book, dividend warrant, and tax deduction certificate.
10	Cash purchases	Cash memos, cash book, goods inward book, store ledger.
11	Credit purchases	Copies of purchase orders placed, purchase invoice, goods inward register, summary statement or supplier's account or correspondence with suppliers.
12	Purchase returns	Purchase return book ,debit notes issues or credit notes received, goods outward register, statement of supplier's account.
13	Payment to creditors	Receipts' from creditors acknowledging the amount received by them, statement of creditors account.
14	Wages and Salaries	Appointment letters, payroll summary, job cards, returns submitted to authorities, salary register, unpaid or unclaimed wages, wage sheets.
15	Travelling expenses	Cash book, air/railway ticket, boarding and lodging bills
16	Freight and carriage	Cash book, bank statement, receipts from transporters, relevant ledger accounts.
17	Income tax	Copy of assessment order, demand notice, challan, cash book,

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	paid	relevant ledger accounts.
18	Donations	Cash book, receipts, articles of association and board's resolution authorizing such donations.
	Sources:-	Singh, A.K. and Gupta, Lovleen, principles of auditing, Mayur paperbacks, New Delhi. Pp 77-78

### Value Addition 9: Did You Know?

#### External Audit Methodology of KPMG

Click on the link below to know about the components of control that are looked into by KPMG while conducting external audit of companies.

Source: <http://www.kpmg.com/gr/en/services/advisory/risk-consulting/it-risk-advisory/pages/irm-external-audit.aspx>

### Summary:

- Audit process is a long and systematic method of analyzing and examining the financial statements.
- The process of auditing begins with some preliminary activities to be undertaken by the prospective auditor in order to ascertain whether to accept or reject an audit assignment, followed by some activities to be taken up after accepting the engagement but before commencing the audit. Once the scope of work and other things are agreed upon, the auditor plans the process of audit.
- The process of audit calls for a detailed audit planning, which means developing of overall plan regarding the procedures, scope and conduct of an effective audit.
- An audit programme refers to the auditor's plan of action. It is detailed plan of work prepared by the auditor, which consists of a set of techniques and procedures that the auditor will apply.
- Audit execution refers to actual implementation of the audit plan and the audit program.
- An auditor's report contains the opinion of the auditor(s) about the true and fair view of the financial statements. It also includes remarks of the auditor at appropriate places, if required; and disclosure of comments if any.
- It can also be seen that auditing framework is dependent largely on its theoretical structure, which comprises of postulates, principles, standards, procedures and techniques.
- All the three terms, internal control, internal check and internal audit are inter-related to each other. While internal control is a management function, internal check is a tool or a technique to facilitate internal control, and internal audit is the mechanism that ensures that internal control is in place.
- Audit risk revolves around three aspects, which are accounting framework, audit framework and client-management agreement with respect to the scope of audit that varies in the case of a general purpose audit and a special purpose audit.
- Vouching is a technique of collecting all the documentary evidence to support transactions.
- Vouching is carried out with certain objectives. But care should be taken to follow basic vouching principles by the auditor.

### Glossary:

- **Audit process:** It is a well defined methodology for organizing and executing audit. It includes planning, execution and reporting.

## Audit Process and Vouching

- **Audit risk:** It is the risk that errors will not be discovered by audit tests.
- **Engagement letter:** It is a letter that represents the understanding about the engagement between the client and the Auditor. The letter identifies the financial statements and describes the nature of procedures to be performed. It includes an explanation of the objectives of the procedures, an explanation that the financial information is the responsibility of the company's management, and a description of the form of report.
- **Evidence** (evidential matter): It includes any written and/or electronic information (such as checks, records of electronic fund transfers, invoices, contracts, and other information) that helps the auditor to form his opinion
- **Working papers** (written audit documentation): Records kept by the auditor of procedures applied, tests performed, information obtained, and pertinent conclusions in the engagement.

### References:

#### 1. Work Cited and Suggested Readings:

- S. K. Basu, Auditing-Principles and Techniques, Pearson Education
- Varsha Ainapure Mukund Ainapore, "Auditing And Assurance" PHI Pvt. Ltd., New Delhi
- Aruna Jha, Student Guide to Auditing, Taxman Allied Service (P) Ltd.
- Kamal Gupta & Ashok Arora, Fundamentals of Auditing, Tata McGraw Hill.
- K.C. Shekhar, Auditing, Vikas Publishing House (P) Ltd.
- S. D. Sharma, Auditing Principles and Practice, Taxmann Allied Services (P) Ltd.
- Tandon, B. N., S. Sudharsanam, and S. Sundharabahu, "A Handbook of Practical Auditing", S. Chand and Co. Ltd., New Delhi.
- Pagare, Dinkar., "Principles and Practice of Auditing", Sultan Chand and Sons, New Delhi.
- Institute of Chartered Accountants of India, "Auditing and Assurance Standards", ICAI, New Delhi.
- Singh, A.K. and Gupta, Lovleen, principles of auditing, Mayur paperbacks, New Delhi.

### Exercises:

#### Objective Type Questions:

A. Which of the following are true and false:-

1. All Accounting Standards issued by ICAI are required to be compulsorily followed in preparation of financial statements of companies in India.
2. An auditor may not comply with the principles listed in the Statements on Standard Auditing Practices, in case he does not have the time and resources to do so.

B. Classify the following audit procedures into compliance procedures and substantive procedures.

1. Preparation of a flow chart showing the detailed procedure for purchases.
2. Examining sales invoices
3. Computing financial ratios from financial statements
4. Circulating an internal control questionnaire
5. Examining debtor account
6. EDP controls evaluation

#### (Answers

True/False: 1. False; 2. False;

B. Compliance procedures- 1, 4, 6; Substantive Procedures- 2, 3, 5)

## Audit Process and Vouching

### Short Answer Type Questions:

1. Write short note on Auditing standards
2. Write short note on Audit planning
3. Explain in brief Contents of Audit engagement letter
4. How will you vouch the following:-
  - cash sales
  - wages
  - rent received
  - receipts from debtors
  - dividend income
  - cash purchases
  - credit sales

### Long essay type questions:

1. Explain the steps that an auditor should take before commencement of a new audit.
2. State the meaning and general principles of vouching. As an auditor, how would you vouch cash sales?

### References:

#### Web Links:

- Visit the link <http://audit-reporting.blogspot.in/p/philosophy.html> to read about philosophy of auditing.
- Visit the link [http://finance.columbia.edu/audit\\_process](http://finance.columbia.edu/audit_process) to see an image on audit process.
- Visit [http://www.auditorgeneral.gov.lk/web/images/stories/contents/auditor\\_geeral\\_en.jpg](http://www.auditorgeneral.gov.lk/web/images/stories/contents/auditor_geeral_en.jpg) to view an image on audit tasks and technical activities.
- Visit the link [http://www4.semo.edu/gjohnson/notes/audit\\_risk\\_model.htm](http://www4.semo.edu/gjohnson/notes/audit_risk_model.htm) to read about audit risk.
- Visit the link [http://www.youtube.com/watch?v=9LW5r9N8\\_nQ](http://www.youtube.com/watch?v=9LW5r9N8_nQ) to watch a video on the difference between vouching and tracing.
- Visit the link [http://www.readyratios.com/reference/audit/audit\\_evidence.html](http://www.readyratios.com/reference/audit/audit_evidence.html) to read about the methods of obtaining audit evidence.
- Visit the link <http://www.readyratios.com/reference/business/voucher.html> to read about vouchers and their types.