Auditing (BBA VIth sem)

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SCE

UNIT 2: Internal check system, internal control, audit procedure: vouching and verification of assets and liabilities

INTERNAL CHECK

Internal Check is an integral function of the internal control system. It is an arrangement of duties of the staff members in such a way that the work performed by one person is automatically and independently checked by the other.

Objectives Of Internal Check

Following are the main objectives of Internal Check –

- To protect business from carelessness, inefficiency and fraud.
- To ensure and produce adequate and reliable accounting information.
- To keep moral pressure over staff.
- To minimize the chances of errors and frauds and to detect them easily on early stage if it is committed.
- To divide the work in such a way that no business transaction should be left unrecorded.
- To fix the responsibility of every clerk according to the division of work.

Advantages of Internal Check

Following are the advantages of a good system of Internal Check –

From the Owner's Point of View

- Good system of Internal Check provides accurate, reliable and genuine accounting record and data to the owner of the business on which he can rely upon.
- Economy in operations and overall efficiency in system due to good Internal Check may result in more profits. From the Auditors Point of View
- Due to efficient system of Internal Check, the statutory Auditor can avoid deep and detailed checking of transactions. He may rely on test checks, hence Internal Check provides convenience to Auditor.
- Since the Balance Sheet and the Profit and the Loss account is prepared without wasting of time, hence quick preparation of final accounts is possible.

For the Business

- Moral Check − Great check to commission of errors and frauds is possible with knowledge of subsequent checking of work of each employee by others.
- Detection of Errors and Frauds − This helps in early detection of errors and frauds because work of each clerk is checked by another automatically and no one is allowed to do complete work from the beginning to the end.
- Proper Division of Work − According to qualification, experience and area of specialization of work, proper and rational distribution of work among the members of staff is done.
- Increases Efficiency − A good internal control system provides increased efficiency of work coupled with overall economy.

Disadvantages of Internal Check

- It is costly for small business units.

• If Internal Check system is not properly organized, there are chances of disorder in the working of business.
• There might be instances where the quality of the product and the work is compromised with by the staff members due to greater importance to faster results.
• An Auditor cannot be relied on if he does not conduct tests with procedures of his own.

INTERNAL CONTROL

Internal control is the process, effected by an entity's Board of Trustees, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
– Reliability of financial reporting,
– Effectiveness and efficiency of operations, and
– Compliance with applicable laws and regulations.

COMPONENTS OF INTERNAL CONTROL

Internal control consists of five interrelated components:
1 control environment;
2 risk assessment process;
3 the information system, communication, and related business processes;
4 control procedures;
5 monitoring of controls

OBJECTIVES

Internal Audit evaluates internal control by accessing the ability of individual process controls to achieve seven pre-defined control objectives. The control objectives include authorization, completeness, accuracy, validity, physical safeguards and security, error handling and segregation of duties.
• Authorization - The objective is to ensure that all transactions are approved by responsible personnel in accordance with specific or general authority before the transaction is recorded.
• Completeness - The objective is to ensure that no valid transactions have been omitted from the accounting records.
• Accuracy - The objective is to ensure that all valid transactions are accurate, consistent with the originating transaction data and information is recorded in a timely manner.
• Validity - The objective is to ensure that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.
• Physical Safeguards & Security - The objective is to ensure that access to physical assets and information systems are controlled and properly restricted to authorized personnel.
• Error handling - The objective is to ensure that errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management.
• Segregation of Duties - The objective is to ensure that duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing the transaction.

LIMITATION

No matter how well internal controls are designed, they can only provide reasonable assurance that objectives have been achieved. Some limitations are inherent in all internal control systems. These include:
• Judgment: The effectiveness of controls will be limited by decisions made with human judgment under pressures to conduct business based on the information at hand.

• Breakdowns: Even well designed internal controls can break down. Employees sometimes misunderstand instructions or simply make mistakes.
Errors may also result from new technology and the complexity of computerized information systems.
• Management Override: High level personnel may be able to override prescribed policies and procedures for personal gain or advantage. This should not be confused with management intervention, which represents management actions to depart from prescribed policies and procedures for legitimate purposes.
• Collusion: Control systems can be circumvented by employee collusion. Individuals acting collectively can alter financial data or other management information in a manner that cannot be identified by control systems.

Basis for Comparison	**Internal Control**	**Internal Audit**
Meaning	Internal Control refers to the methods and procedures implemented by the management to control the operations, so as to assist in achieving the business objective.	Internal Audit alludes to the auditing program adopted by the firm, to review its financial and operating activities by the professional.
What is it?	System	Activity
Verification	One person's work is verified by another.	Each and every component of work is verified.
Time of checking	As soon as the transaction is recorded checking is performed.	Checking is done after the work is performed.
Objective	To ensure compliance with management policies.	To detect fraud and error.

The Points of distinction between internal check and internal control are as follows.

S.No	Basis	Internal Check	Internal Control
1.	Meaning	A system of allocation of responsibility, division of work, and methods of recording transactions, whereby the work of an employee is checked continuously by another.	It consists of all the methods and procedures adopted to assist in achieving the objective of efficient conduct of business. It includes internal check and internal audit.
2.	Scope	It operates in routine to double check every part of a transaction at the time of occurrence and recording of the same.	In internal control systems, work of one person is automatically checked by another.
3.	Objective	Its objective is to ensure that no one employee has exclusive control over any transaction or group of transactions and their recording in the books.	Its object is to ensure adherence to management policies, safeguarding of assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records.
4.	Point of Time	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.	In internal control system, checking is done simultaneously with the conduct of work. Every transaction is checked as soon as it is entered.
5.	Thrust of System	The thrust of internal check system is to prevent errors.	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.
6.	Cost Involved	It is a part of internal control and a method of division of work, therefore does not add to the cost.	The system proves to be costly in case of small businesses because more number of employees are engaged.
7.	Report	The summary of day to day transactions work as report to the senior.	Internal control provide for built in MIS reports.

➢ Internal Check-Sales

Sales are the most important source of revenue in a business and hence the possibilities of errors and frauds taking place are greater. Frauds maybe committed in the following ways:

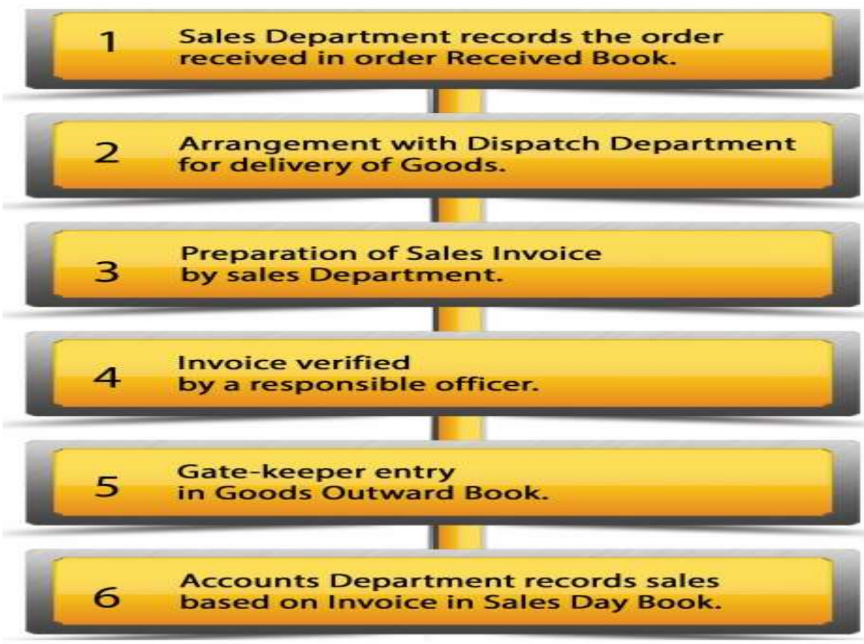
· Sales may be omitted from recording in the sales book.

· Fictitious sales may be accounted.

· Sale of fixed assets may be treated as sale of goods.

In order to overcome the occurrence of such type of frauds, an effective system of internal check as regards credit sales is necessary that may be in the following manner.

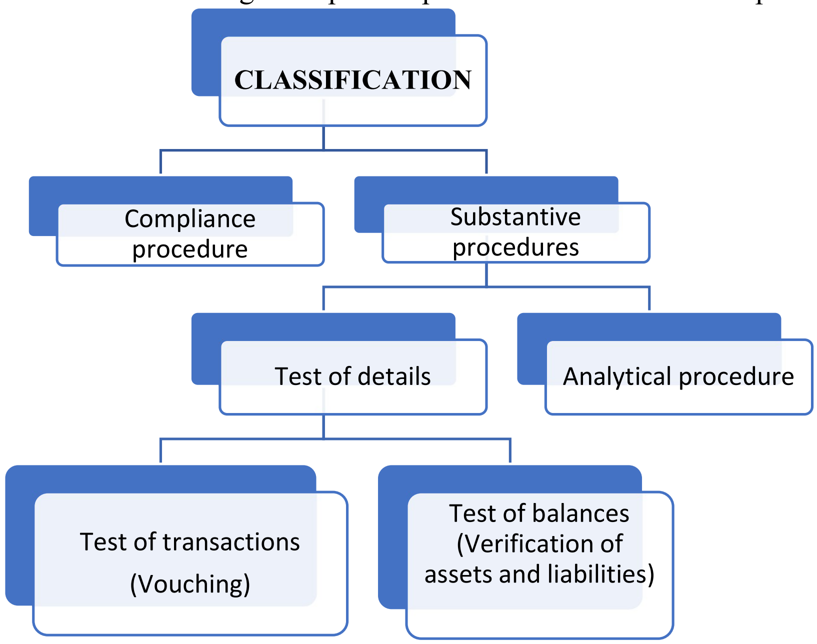
1. On receipt of order from the customers, it should be numbered and the particulars entered in the order received book.
2. The order copy should be handed over to the dispatch department who makes necessary arrangements for delivery of goods.
3. When the goods ordered or ready for delivery the dispatch department should inspect the goods with the order copy and enter the details of goods delivered in the dispatch memo.
4. The invoice should be prepared based on the dispatch memo in three copies, one copy should be sent to the customer, second copy to the accounts department and third copy will be retained by the sales department.
5. A responsible official should check the particulars in the invoices and also confirm that the terms and conditions in the order have been duly followed and finally he should put his initial on the invoice.
6. The gatekeeper should record particulars of the goods leaving the premises in the goods outward book.



7. The persons who are responsible for preparing the invoices should not be allowed to post the entries in the customer’s accounts.
8. At frequent intervals, the balances in the customers’ accounts should be verified with the confirmations received from the customers.
9. A responsible official should verify that only sale of goods are accounted in sales day book and sale of assets are not accounted.
10. A responsible official should deal with customers enquiries, overdue accounts and writing off bad debts.

AUDIT PROCEDURE

Auditor obtains evidence through compliance procedures and substantive procedures



Audit Procedures are steps performed by auditors to get all the information regarding the quality of the financials provided by the company, which enable them to form an opinion on financial statement whether they reflect the true and fair view of organisation financial position. They are identified and applied at the planning stage of the audit after determining audit objective, scope, approach, and risk involved.

Compliance procedure-

Audit tests designed to obtain a reasonable assurance as to reliability of internal control system.

a. Existence of internal control system
b. Effectiveness in operation of internal control system
c. Continuity of internal control system

Substantive procedures

Substantive procedures are processes, steps, tests performed by auditors, which creates conclusive evidence regarding accuracy, completeness, existence, disclosure, rights, or valuation of assets/ liability, books of accounts, or financial statements. For any procedure to be concluded, the auditor should collect enough audit evidence so that another competent auditor, when applies the same procedure on the same documents, makes the same conclusion. It can be regarded as complete checking. They seek to test –

A. Existence of assets and liabilities
B. Rights and obligations in form of assets and liabilities
C. Occurrence of transaction or events
D. Completeness in recording

E. Valuation of assets and liabilities
F. Measurement of transaction at proper amount
G. An item is disclosed, classified, and described in accordance with relevant accounting policies and practices and relevant statutory requirements

Analytical procedures

Analytical procedures can be defined as tests/ study/ evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. In simple language, certain checks/tests conducted by auditors based on study/ knowledge/ previous year figures to check and form an opinion on financial statements. Depending on the audit area, the analytical audit procedure may differ.

Types of Audit Procedures

- Inspection – Inspection is the most commonly used method. Under this, the auditor checks every transaction/ document against written steps, procedures to ensure accuracy.

- Observation – Under this technique of audit, the auditor usually tries to inspect others doing/ performing a particular process. E.g., An auditor may observe steps followed in processing GRN (gods received note) against goods purchased.

- Confirmation – This type is applied to ensure the correctness of financial statements either from internal sources within the auditee organization or from external sources.

- Recalculation – Under this audit method, the auditor usually crosses the checks information presented by the client. It is generally used in case of checking mathematical accuracy.

- Reperformance – Using this procedure, the auditor reperform the entire process is performed by the client to find out gaps, audit findings, etc

VOUCHING

Meaning of VOUCHING: The act of examining documentary evidence in order to ascertain the accuracy and authenticity of entries in the books of account is called "Vouching".

In other words vouching means a careful examination of all original evidences **that is invoices, statements, receipts, correspondence, minutes, contracts etc.** with a view to ascertain the accuracy of the entries in the books of accounts and also to find out, as far as possible that no entries have been omitted in the books of accounts.

DEFINITION OF VOUCHING: According to Dicksee."Vouching consists of comparing entries in books of account with documentary evidence in support thereof".

OBJECTIVES OF VOUCHING

- Each and every transaction is verified and ratified on the basis of documentary evidences, so that the accuracy of the transaction can be known.
- Vouching is done to find out the errors and frauds committed in the books of accounts.
- To have accuracy in presenting the financial reports as true and fair

- Through vouching we can know that the transactions in the books of accounts are authorised by the competent authority.
- To find out accuracy of entries appearing in the BOA
- To ensure that the distinction has been made between the capital and revenue items while recording the transactions.

IMPORTANCE/ADVANTAGES/MERITS OF VOUCHING

- Vouching with diligent care and intelligence ensures the success of an audit work
- Vouching is a vital technique of an auditor to check the regularities and irregularities of the transactions.
- It is only through vouching the true and fair view of the books of accounts ,financial statements and reports can be certified by auditor
- It helps to know whether documentary evidences are authorized by the responsible authority.
- Vouching helps to know that the transactions which are recorded are related to business.

ROUTINE CHECKING AND VOUCHING

Routine checking covers the checking of every carry forward, posting to ledger account and balancing of account.

Vouching includes routine checking which is a mechanical checking, whereas vouching is made on the basis of documentary evidence.

A voucher may be a sales bill, purchase bill, payment receipt, pay-in slip, etc. All such types of documentary evidence are known as vouchers.

DIFFERENCE BETWEEN ROUTINE CHECKING AND VOUCHING

Routine checking	**vouching**
➢ Comprise of checking arithmetical accuracy and clerical errors	➢ Checking of transactions and its validity and authenticity
➢ Its objective is to verify that the accounts have been correctly balanced	➢ The object is to vouch on documentary evidence
➢ Routine checking is included in vouching	➢ Vouching is a broader term as it includes routine checking
➢ Simple and mechanical	➢ Intelligent and systematic process
➢ Scope is limited	➢ Wider scope
➢ Reveals minor frauds	➢ Reveals all kinds of errors and fraudulent activities

VOUCHERS

MEANING**:** A voucher is a written paper or document in support of an entry in the books of account**.**

Voucher is known as the evident for the support of a transaction in the books of account. It may be bill, receipts, requisition form, agreement, decision, bank paying slip etc.

PRINCIPLES OR TECHNIQUES OF VOUCHING:

At the time of vouching auditor should keep in view the following important principles in his mind…

1. *Arranged Vouchers*: First of all auditor should check all the vouchers provided by the client are properly arranged. These are in the same order as the entries are made in the books.

2. *Checking of Date*: The auditor should compare the date of the voucher with the date recorded in the cash book.

3. *Compare the Words and Figures*: The auditor should satisfy himself amount written numbered consecutively. All the vouchers should be properly filed. On the vouchers, its figures and words are same or not.

4. *Checking of Authority*: The auditor should examine that all the vouchers are passed by the authorized officer. If the voucher is passed by unauthorized person it will not be correct.

5. *Cutting or Change*: If there is any cutting or change on the receipts and vouchers figures it should be signed by the authorized officer. The auditor should satisfy himself by inquiring about it.

6. *Transaction must relate to business*: The auditor should carefully examine that the entries must relate to the business.

7. *Case of Personal Vouchers*: The auditor should not accept the voucher in personal name. There is a chance that an officer of the company has purchased any item in his personal capacity.

8. *Checking of Account Head*: Auditor must be satisfied about the head of account on which cash is deposited and drawn. He should examine the documentary evidence in this regard.

9. *Revenue Stamp*: The auditor should also check that voucher bears a required revenue stamp or not?

10. *Case of Cancelled Voucher*: The auditor should not accept the cancelled voucher because it has already served the purpose of payment. There will be a danger of double payment if it is accepted.

11. *Important Notes:* The auditor should take some important notes about those items which need further evidence or explanation.

12. *Payment:* The auditor should check that whether payment is described partially or for

complete transaction of sale.

13. *Agreements*: These provide the basic information to the auditor. He should check the agreements, correspondence and other relevant papers.

14. *Printer Vouchers:* Printer vouchers are considered true and these are legally acceptable. If these are not printed then these are useless.

15. *List of Missing Vouchers*: Auditor should prepare the list of missing vouchers. This list will be helpful in detecting the fraud and errors.

TYPES OF VOUCHER

- **Primary Voucher:** Written evidence in original is said to be the primary voucher, for example, invoice for a purchase.
- **Collateral Voucher**: When the original voucher is not available, copies thereof are produced in support or subsidiary evidence in order to remove doubt from the mind of auditor. Such a voucher is usually known as a collateral voucher.

VOUCHING OF ITEMS-

ITEMS	**PROCEDURE**	**DOCUMENTARY EVIDENCE**
Credit sales	Examine sales book Examine sales invoices Examine numerical sequence of source documents generated within the organisation Examine treatment of additional charges and trade discount Routine checking Examine cut off points	Sales book Sales invoice book Goods outward book Transporter receipt Purchase order
Sales return	Examine sales return book Examine credit notes Examine cut off points	Sales return book Credit notes Inward return notes Inspection reports
Credit purchase	Examine purchase book Examine purchase invoices Examine numerical sequence of source documents generated within the organisation Examine cut off points	Purchase book Purchase invoice Purchase requisition Purchase order Goods received notes
Purchase return	Examine purchase return book Examine debit notes Examine cut off points	purchase return book debit notes goods outward notes advice notes original purchase invoice

ITEMS	**PROCEDURE**	**DOCUMENTARY EVIDENCE**
Cash receipts or debit side of cash book	Examine cash book Examine the counterfoils of pay-in-slips Examine cash memos Examine the carbon copies of receipts	Cash book Counterfoils of pay-in-slips Carbon copies of receipts Cash memos

	Routine checking	Relevant documentary evidence like broker sold note, tenancy agreement etc.
Cash payment or credit side of cash book	Examine the payment in cash book Examine bank statement Routine checking	Cash book Bank statement Cash memo Relevant documentary evidence like stock ledger, job cards, pay roll summary, relevant registers etc.

Teeming and lading is a bookkeeping fraud also known as short banking, delayed accounting and lapping. It involves the allocation of one customer's payment to another in order to make the books balance and often in order to hide a shortfall or theft. One of the common practices that is performed in this fraudulent activity, is that the amounts received from the debtor is credited to the earlier debtor's account so that one debtor's account does not show an outstanding balance for a long time. Such a process is continued until the time the original amount misappropriated is finally replaced or until the cashier is caught. Auditors pay special attention during the vouching process as part of the verification of transaction to identify teeming and lading.

VERIFICATION

"Verification is the proof of accuracy of extension, footings, posting, existence and ownership of assets." (Arthur Holmes)

"The duty of an auditor in verifying the assets is two-fold. He must satisfy himself that they really existed at the date of the balance sheet and were free from any charge and that they have 4 been properly valued. In verifying the liabilities he has to see that all liabilities have been inserted at their proper figures and that no liability has been omitted." J.R. Batliboi

OBJECTIVES OF VERIFICATION

There are number of key attributes or assertions implied in the balance, and these provide the objectives against which auditor is seeking verification. The auditor must collect evidence to satisfy six objectives. These are:

1. *Completeness,* which concerns whether the account balance in the financial statements represents all of the underlying assets, liabilities, income or expense, e.g. are all the fixed assets owned by the client recorded in the financial statements?

2. *Existence*, which concerns whether the account balance represents real assets or liabilities and whether any items have been duplicated, e.g. does the account balance represent fixed assets that physically exist?

3. *Accuracy*, which refers to whether the item has been correctly recorded with respect to party, price, date, description, and quantity, e.g. looking at the underlying entries for the account, has the clerk pressed the correct buttons on the calculator or the correct keys on the keyboard, or has the depreciation charged been correctly calculated?

4. *Valuation,* which concern whether the account balance is valued at the appropriate amount, e.g. has the correct depreciation rate been used, is that rate appropriate and is the fixed asset worth the amount at which it is recorded.

5. *Ownership*, which relates to a question of title – whether the asset is the property of the company, e.g. is the fixed assets owned by the company, or is there evidence that a third party such as a leasing

company has an interest, or has the company bought assets which are subject to „reservation of title‟ clauses?
6. *Presentation*, which relates to the manner of presentation of an account balance in the financial statements, e.g. whether creditor have been correctly split between short and long-term creditors.

DUTY OF AUDITOR AS REGARD TO VERIFICATION

"Auditor is not a valuer and cannot be expected to act as such. All that he can do is to verify the original cost price and to ascertain as far as possible that the current values are fair and reasonable and are in accordance with the accepted commercial principles." Lansacart
"An auditor is not liable, if in the absence of suspicious circumstances, he relies on trusted official of the company". In re: Kingston Cotton Mills Ltd.

An auditor's duty regarding verification involves ensuring the accuracy and reliability of assets and liabilities presented in financial statements by confirming their existence, ownership, and valuation.

DIFFERENCE BETWEEN VALUATION AND VERIFICATION

1. Meaning:
   Verification means checking whether the assets shown in the balance sheet are in the name of business, whether they exist or not, whether there is any charge on it etc.
   Valuation means determining the proper values of assets and liabilities shown in the balance sheet
2. Nature of Work:
   Verification examines the assets & liabilities shown in balance sheet, Valuation examines the entries relating to the transactions recorded in the account book. B.
3. Time:
   Verification is made at the end of the financial year. Valuation is done for the whole year's transactions.
4. Purpose
   The purpose of verification is to check existence, ownership and possession of assets. The purpose of valuation is to determine the proper values of assets as per generally accepted principles.
5. Basis:
   The basis of verification is the type of assets, and liabilities. There is not fixed method of verification. The basis of valuation of assets is the types of assets are valued on different basis.
6. Personnel:
   Verification is done by auditor himself or his assistant ,whereas Vouching is done by juniors like audit – clerk .
7. Certificate
   The auditor is not able to get certificate of verification of assets and liabilities. The auditor is entitled to get certificate of valuation of assets from responsible officer of the business unit.
8. Vouching
   Verification includes vouching. Valuation does not include vouching.
9. Scope
   The scope of verification is wide. It includes checking of many things like existence, ownership, possession etc. The scope of valuation is limited. Here only values of assets and liabilities are determined and checked.

DIFFERENCE BETWEEN VOUCHING AND VERIFICATION

Basis for Comparison	**Vouching**	**Verification**

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.

VERIFICATION OF ASSETS

"Verification of assets implies an enquiry into the value, ownership and title, existence and possession and the presence of any change on the assets." Spicer and Pegler

According to Joseph Lancaster "Verification of assets is a process by which the auditor substantiates the accuracy of the right-hand side of the Balance Sheet, and must be considered as having three distinct objects :

(a) the verification of the existence of assets

(b) the valuation of assets and

(c) the authority of their acquisition".

GENERAL PRINCIPLES REGARDING VERIFICATION OF ASSETS

The auditor should verify the following points while conducting verification of assets (As laid down by ICAI):

1. That the assets were in existence on the date of balance sheet;

2. That the assets had been acquired for the purpose of the business and under a proper authority;

3. That the right of ownership of the assets vested in or belonged to the undertaking;

4. That they are free from any lien or charge not disclose in the balance sheet;

5. That they are correctly valued having regard to their physical condition; and

6. That their values are correctly disclosed in the balance sheet.

7. Where a company or partnership has taken over the assets of a going concern, the agreement of sale should be inspected and that amount paid for them ascertained. It should be further verified that the allocation of total cost among the various assets is fair and reasonable.

8. The cost of assets acquired piecemeal should be verified with their invoices, purchase agreements, or ownership rights and the receipts of the sellers in respect of the price paid. It should be verified that expenditure on assets newly acquired and that on the renewal and replacement of old assets has been correctly recorded, consistent with the method that has been generally followed in the past.

9. When an asset is sold, its sale-proceeds should be vouched by reference to the agreement, containing the terms and conditions of sale, counterfoil of the receipt issued to the purchaser or any other evidence which may be available. If the sale of fixed assets resulted in capital profit, it should be transferred to capital reserve. However, the profit limited to original cost or a loss should be transferred to the Statement of Profit and Loss.

10. It is obligatory for a company to provide for depreciation out of the profits in accordance with provisions under sub section (1) of section 123, before any profits can be distributed as dividend. The law requires that depreciation should be provided in the manner as specified in Schedule II of the Companies Act, 2013.

11. The existence of fixed assets, where practicable, should be verified by a physical inspection and, or by comparing the particulars of assets as are entered in the Schedule attached to Balance Sheet, with the plant or property register and reconciling their total values with the General Ledger balances.

12. Wherever possible, all the securities and document of title, cash, negotiable instruments, etc. representing the assets, should be inspected at the close of the last day of the accounting period. If this is not practicable and the examination is undertaken at the later date, a careful scrutiny of transactions subsequent to the date of the balance sheet must be made to ensure that the changes in their balance that have subsequently taken place and are supported by adequate evidence.

13. It should be ascertained that no unauthorized charge has been created against an assets and all the charges are duly registered and disclosed. Where shares or securities are lodged with a bank to secure a loan or an overdraft, a certificate should be obtained from the bank showing the nature of the charge, if any.

14. Where assets, e.g., government securities, share scrips and debenture bonds are in the custody of a third party other than bank, they must be inspected.

15. Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, should be disclosed separately.

FOR EXAMPLE

Freehold Land and Building

Freehold property is in the name of the client. He has full rights over it and is the complete owner of it. It is a permanent asset of the business. Its verification should be done as under:

(i) Examination of Ownership. The auditor should examine the title deeds to ensure that they are in the name of the client. The title deeds should cover all the land and buildings shown in the balance sheet.

(ii) Examination of Charge. If the property is under charge or it has been mortgaged, the auditor should obtain a certificate from the mortgagee.

(iii) Physical Inspection. The auditor should physically examine the property to see if it really exists and for what purpose it is being used.

(iv) Valuation. The auditor's duty is to see whether the property has been valued according to the laws of book keeping or not. Valuation of land is generally shown at cost.

(v) Examination of Construction. If the construction work has been done by the employees of the concern, it should be properly examined. To be on the safe side, a certificate from a responsible officer should be obtained to this effect.

(vi) Revenue Expenses. Expenses on repairs and new construction during the year should be debited to Revenue A/c.

(vii) Sale Vouching. If the land or building has been sold, its vouching should be checked.

(viii) Examination of depreciation. The auditor should see whether proper depreciation has been provided for land or building.

VERIFICATION OF LIABILITIES

Verification of liabilities is as important as assets. If any liability omitted or overstated or understated in the Balance Sheet then Balance Sheet would not show true and fair view of the state of affairs of the business. Therefore the auditor must verify that the liabilities stated in the Balance Sheet are in fact payable, accurate, related to and exist in the business.

The judgment in the Westminster Road Construction and Engineering Co. Ltd, 1932 is of great significance in this regard. As per this judgment, "if the auditor found that a company in the course of its business was incurring liabilities of a particular kind and that the trade payables sent in their invoices after an interval and that liabilities of the kind in question must have been incurred during the accountancy period under audit when he was making his audit, sufficient time has not elapsed for the invoices relating to such liabilities to have been received and recorded in the company"s books, it become his duty to make specific inquiries as to the existence of such liabilities and also before he signed a certificate as to the accuracy of the Balance Sheet to go through the invoices files of the company in order to see that no invoice relating to liabilities has been omitted. The evidence has established to my satisfaction that no experienced auditor would have failed to ascertain the existence of the liabilities omitted from the Balance Sheet. "

The auditor verifies liabilities also along with assets and for doing so he has keep the following points into consideration:

1. To verify the existence of liabilities shown in balance sheet and liabilities shown in the balance sheet have arisen out of business operation.

2. To verify that liabilities as shown in the balance sheet are actually payable.

3. To verify the correct value of such liabilities.

4. To verify that all existing liabilities are actually included in the account and doubtful liabilities should not be included in the actual liabilities.

5. To verify the adequacy of disclosure.

Verification of liabilities may be carried out by employing following procedures:

1. Examination of records;

2. Direct confirmation procedures;

3. Examination of disclosures;

4. Analytical review procedures;

5. Obtaining management representation

GENERAL PRINCIPLES REGARDING VERIFICATION OF LIABILITIES

It is not possible to detail the procedures for verifying all possible liabilities. However some general principles can be discerned and these should be applied according to the particular set of circumstances met with in practice in an examination. These are:

a) Schedule: Request or make a schedule for each liability or class of liabilities. This should show the make-up of the liability with the opening balance, if any, all changes, and the closing balance.

b) Cut-off: Verify cut-off. For example a trade creditor should not be included unless the goods were acquired before the year end.

c) Reasonableness: Consider the reasonableness of the liability. Are there circumstances which ought to excite suspicion?

d) Internal control: Determine, evaluate and test internal control procedures. This is particular important for trade creditor.

e) Previous date clearance: Consider the liabilities at the previous accounting date. Have they all been cleared?

f) Terms and conditions: This applies principally to loans. The auditor should determine that all terms and conditions agreed when accepting a loan have been complied with.

g) Authority: The authority for all liabilities should be sought. This will be found in the company minutes or directors‟ minutes and for some items the authority of the Memorandum and Articles may be needed.

h) Description: The auditor must see that the description in the accounts of each liability is adequate.

i) Documents: The auditor must examine all relevant documents. These will include invoices, correspondence, debenture deeds etc. according to the type of the liability.

j) Security: Some liabilities are secured in various ways, usually by fixed or floating charges. The auditor must enquire into these and ensure that they have been registered.

k) Vouching: The creation of each liability should be vouched, for example the receipt of a loan.

l) Accounting policies: The auditor must satisfy himself that appropriated accounting policies have been adopted and applied consistently.

m) Interest and other ancillary evidence: The evidence of loans tends to be evidenced by interest payments and other activities which stem from the existence of the loan.

n) Disclosures: All matters which need to be known to receive a true and fair view from the accounts must be disclosed,

o) External verification: With many liabilities it is possible to verify the liability directly with the creditor. This action will be taken with short-term loan creditors, bank overdrafts and by a similar technique to that used with debtors, the trade creditors.

p) Materiality: Materiality comes into all accounting and auditing decisions.

q) Accounting Standards: Liabilities must be accounted for in accordance with the accounting standards.

r) Risk: Assess the risk of misstatement.

FOR EXAMPLE –

Bank Overdrafts For the verification of the balance of bank overdrafts and interest thereon, the auditor should examine the confirmatory letter from the bank, cash book and the pass book.