

Unit - 4

VOUCHING

4.1 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. Vouching is very useful in proving the accuracy of the entries in the books of accounts. It also indicates about that transaction which is omitted from the books of account.)

Vouching involves not only the substantiating the entry in the books of account with any documentary evidence like assessments, receipts, counterfoils of receipt book or paying-in-book, contracts but also involves seeing that the transactions have been properly authorized, recorded and entered in the books of account. It tests the truth of items appearing in the books of original entry. The act of examining documentary evidence in order to ascertain the accuracy of entries in the account books is called “Vouching”. Vouching is a technical term which refers to the inspection by the auditor of documentary evidence supporting and substantiating a transaction.

Definition

1. “Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof”.
- **L.R. Dicksee**
2. “Vouching is an examination of the ledger entries as will satisfy the auditor not only that the entry is supported by the documentary evidence but it has been properly made upon the books”.
- **Joseph Lancaster**
3. “Vouching refers to the inspection of documentary evidence supporting and substantiating transaction.
- **Ronald Irish**
4. “Vouching is a documentary evidence in support of entries) is often referred to as vouching.
- **R.K. Mautz**

4.2 OBJECTIVES OF VOUCHING

The main objects of vouching are as follows :

- 1 Verifying the genuineness of the transactions recorded.
- 2 Establishing that all transactions relating to the business have been recorded.
- 3 Determining the authenticity and validity of the documentary evidence.
- 4 Checking that transactions, which are not connected with the business, are not recorded.
- 5 Ascertaining that money has been actually paid away by the business in respect of a business transaction only.
- 6 Ensuring that no fraudulent payments have been made.
- 7 Ascertaining the correctness of the transactions.

4.3 IMPORTANCE OF VOUCHING

Vouching is the act of checking evidential documents to find out errors and frauds and to know the authenticity, accuracy and reliability of books of accounts. Thus, it is important for an auditor due to the following reasons:

- 1 **Vouching Is the Backbone Of Auditing :** Main aim of auditing is to detect errors and frauds for proving the true and fairness of results presented by income statement and balance sheet. Vouching is only the way of detecting all sorts of errors and planned frauds. So, it is the backbone of auditing.
 - 2 **Vouching Is The Essence Of Auditing :** Auditing not only checks the accuracy of books of accounts but also checks whether the transactions are related to business or not. All the transactions are performed after the prior approval of concerned authority or not, transactions are real or not because an accountant may include fictitious transactions to commit frauds. All these facts can be found with the help of vouching. So, vouching is essential for auditing.
 - 3 **Vouching Is Important To See Whether Evidences Are Correct Or Not :** An auditor checks the books of accounts to detect errors and frauds. Frauds may be committed presenting duplicate vouchers. All the small and big amounts of frauds can be detected with the help of vouching. So, all the evidential documents and records are to be checked carefully and in detail by an auditor which is the scope of vouching.
- Therefore, it can be said that vouching is the heart of auditing because without the work of vouching, the work of auditing cannot be performed.

4.4 PRINCIPLES 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.

4.5 TYPES OF VOUCHERS

1. **Primary Voucher** : A written evidence in original is said to be the primary voucher, for example, invoice for a purchase.
2. **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.

4.6 EXAMPLES OF VOUCHERS

Nature of Transactions	Vouchers available
Cash Received	Counterfoil, carbon copies of receipts issued, correspondence, and carbon copies of the contract made.
Cash Paid	Invoices, bills, salary register, wages book copies of the agreement, and correspondence.
Purchases	Copies of order letters, invoices, correspondence, and goods inward book.
Purchase Return	Credit note, goods outward books, letters, and correspondence.
Sales	Order letters received, goods supplied bills, goods outward book and other correspondence or letters.
Sales Returns	Credit notes, goods inward book, letters, and correspondence.
Bills of Exchange	Cash books entries and bills on hand
Assets Purchases	Bills, invoices, deeds, agreements, correspondence, cash memos and affidavit.

4.7 POINTS TO BE NOTED WHILE VOUCHING

1. While vouching a transaction, auditor must verify the authenticity of transaction, accuracy of amount recorded and proper classification of account.
2. Auditor should see that all the vouchers are numbered serially and dated. If these are not arranged serially, first of all they should be serially arranged, otherwise the auditor will be wasting his time in locating a voucher.
3. The voucher, which has been checked by the auditor, should be stamped or tick, marked with a special sign, so that it may not be used again for a fictitious transaction.

4. The amount in the receipt must be shown in words and figures. If the two differ, then it should be investigated.
5. The receipt should indicate the period for which the payment has been made.
6. If the voucher is in the personal name of the partners, manager, director or any other person, it should be seen that proper treatment for such transaction has been provided in the books.
7. If any voucher is doubtful, the auditor should proceed cautiously and use special ticks for such vouchers.
8. It should be seen that every voucher is certified by a responsible officer of the business.
9. For missing vouchers, auditor should ask for explanation from the concerned official. If no satisfactory reply is received then it should be further investigated.
10. While vouching, the auditor should not take any help from client's staff.
11. All vouchers must relate to the business.
12. Voucher is properly affixed with a revenue stamp as per the requirement of law.
13. While vouching transaction auditor should keep in mind that distinction is made between capital and revenue items.
14. For certain transactions, auditor may refer the resolutions passed at the meeting of shareholders or Directors. Sometimes the agreement made with a party may serve as documentary evidence for the transactions arising out of this agreement.
15. Auditor shall not resort to test checking unless a satisfactory internal control system exists in the organisation.
16. As far as possible vouching of a book of accounts of a particular period must be completed in one continuous sitting.
17. Alterations in the vouchers must be supported by concerned officer's initials.

4.8 MECHANIZED ACCOUNTING

In the traditional manual system of accounting, a lot of steps were involved in recording the Accounting transactions. In the present day business scenario a lot of information can be fetched in very less time, without spending a lot of workforce and resources. Therefore, various machines are doing the work of recording and presenting accounting transactions.

Advantages of Mechanized Accounting

- ◆ It saves time and cost in recording accounting transactions.
- ◆ Machines works very efficiently, hence chances of errors are reduced.

- ◆ It enhances speed of work.
- ◆ Accounting through machines is neat and legible.
- ◆ Without any delay final accounts can be prepared any time.
- ◆ Cost of internal control system and Internal Check can be minimized.
- ◆ Desired number of copies of any record is easily available.
- ◆ Past year's data and record can be reproduced in desired form without any delay.

Disadvantages of Mechanized Accounting

Mechanized Accounting comes with its own set of disadvantages. A few of them have been mentioned below.

- ◆ Wrong punching of data at initial stage will produce wrong results.
- ◆ Loose cards and sheets maintained under it are not acceptable by court.
- ◆ It is very difficult to locate and rectify error in it.

4.9 MECHANIZED ACCOUNTING AND AUDITOR

An Auditor should consider the following points while conducting audit of mechanized accounting records :

- ◆ He must verify original data punching.
- ◆ Scrutiny of internal control system is must.
- ◆ He must ensure that actual and authorized accounting transactions shall be recorded.
- ◆ He must obtain explanation, if any, required in any entry.
- ◆ He requires certificate whether machines are in order and working properly or not.

4.10 VOUCHING OF TRADING TRANSACTIONS

(Trading transactions include, purchases, sales, purchase return, sales return, on the basis of consignment, hire purchase, sale or return, etc. Before commencing vouching and verification of the trading transactions, the auditor has to examine the effectiveness of the internal control systems in book keeping, compliance of accounting principles; and maintenance of stock records.)

4.11 VOUCHING OF PURCHASE TRANSACTIONS

(The major purpose behind the vouching of purchase book is to confirm that every purchase bill is entered in purchase book and the invoices entered in purchase book are against the actually received goods and payment is made for those actual purchases.)

4.12 INTERNAL CONTROL FOR PURCHASE

The Auditor has to study the adequacy of internal control system in an organization. Normal internal control system for purchases is given below :

- ◆ Department which requires material or store department will send purchase requisition to the purchase department after getting it signed by the head of the department. Quality and quantity of the required material should be clearly mentioned on the requisition.
- ◆ After getting authorized requisition from the store or other department, the purchase department will invite quotations from different suppliers; the purchase department will then choose the best price quotation with the best quality products.
- ◆ A purchase order will be issued to the supplier of goods who is ready to supply the goods on most favourable terms and conditions. One copy of the purchase order will be sent to the supplier of goods, the second one to the store department, the third one to the accounts department and the fourth one to goods receiving department, and one copy will be retained by the purchase department itself.
- ◆ On receiving the goods, the Material Receipt Note (MRN) will be issued by the goods receiving department after the checking and verification of quantity, price and quality of material of goods with purchase order. The material along with the Material Receipt Note will be sent to the store department, one copy each of MRN will be sent to the accounts department and the purchase department.
- ◆ After the verification of the purchase invoice and the MRN, the accounts department will pass the bill for payment and the payment will be done by the accounts department according to the payment terms.

The Auditor has to verify the complete internal control system as stated above.

4.13 DUTIES OF AUDITOR

The Auditor has to check and verify the following :

- ◆ Record of all purchase orders.
- ◆ Verification of quantity, price and payment terms of purchase invoice with purchase orders.
- ◆ Verification about whether goods actually received.
- ◆ Verification about proper recording of purchase bill in purchase book.
- ◆ Goods purchase should be for business purpose only, not for any personal use of any partner, director or officer of the company.
- ◆ The Auditor should verify the statements of accounts of suppliers.

4.14 VOUCHING OF PURCHASE RETURN BOOK

There are times when due to the quality of purchase goods or due to excess supply of ordered goods or any other reasons, goods are returned back to supplier. The Auditor needs to verify the following points :

- ◆ A debit note or purchase return invoice should be prepared mentioning the original purchase invoice number, quantity, price, applicable taxes, etc. These should be according to the original purchase invoice against which material was purchased.
- ◆ A corresponding credit note should be received from the supplier.
- ◆ Separate goods return book should be maintained.
- ◆ Adjustment of the amount of goods return invoice should be done while making payments to the supplier.

4.15 VOUCHING OF GOODS SENT ON CONSIGNMENT BASIS

Consider the following points for the vouching of Goods Sent on Consignment Basis.

- ◆ Goods sent on consignment basis by the principle to his agent are not a sale.
- ◆ Entry of sale should be made only when goods are actually sold by the agent.
- ◆ At the time of valuation of stock of principle (Consignor), unsold goods lying at the godown of agent (Consignee) should also be considered as stock.
- ◆ Separate books for goods sent on consignment should be maintained by the consignor.
- ◆ At the end of the year, the consignee sends a statement showing the goods received, during the year, goods sold and the unsold stock at the end of the year.
- ◆ Auditor should verify the proforma invoice, goods outward register, etc.

4.16 VOUCHING OF CREDIT SALE

Most of the sales are made on credit basis and the internal control system for the same is given below :

Internal Control for Credit Sale

- ◆ A separate sale order register should be maintained showing the detail of goods ordered, name of the customer, order number, quantity ordered, schedule time for dispatch, price, mode of delivery, payment terms, particulars of taxes and insurance. The sales order needs to be entered in the register as soon as it is received.
- ◆ Sale order will be sent to dispatch department.
- ◆ Dispatch department will arrange material to be sent to customer.
- ◆ On the basis of sale order and dispatch challan, sale invoice is issued.

- ◆ Sales invoices need to be entered both in the outward register and also the sales book.
- ◆ Payment will be received according to the payment terms.

Duties of Auditor

- ◆ An Auditor should verify the complete internal control system of sale as described above.
- ◆ The sale invoice should check with sale order.
- ◆ Sale register will check through sale invoices.
- ◆ Sale of capital goods should not be recorded in sale account.
- ◆ Calculation of sale invoice should be check in case of manual invoicing.
- ◆ Accounting for taxes should be in separate account like excise duty, service tax, VAT, Central Sales Tax, etc.
- ◆ No sale invoice should be unrecorded in the sales book.
- ◆ Only the sales of the current year should be recorded for the current year.
- ◆ Cancelled invoices should be kept separate for verification of Auditor.
- ◆ No separate entry for trade discount should be passed; it should be adjusted in the sales value.

4.17 VOUCHING OF SALES RETURN

There may be many reasons for return of sold goods by the customers. Few of them are wrong supply of material, excess quantity or below standard quality, etc. The Auditor should carefully check the following :

- ◆ Separate sale return register should be maintained for sale return.
- ◆ Credit note should be issued after obtaining proper sanction from the responsible officer.
- ◆ Goods inward register should be checked.
- ◆ The reason for return of goods should be analysed.
- ◆ Date of return of goods should be verified with debit or credit note, goods inward register.
- ◆ Store records should be checked.
- ◆ Customer account should be credited with the sale return amount.
- ◆ At the time of valuation of the closing stock, returned goods should be valued at "cost or market price whichever is low."

4.19 VOUCHING OF CASH TRANSACTIONS

In a business concern, cash book is maintained to account for receipts and payments of cash. It is an important financial book for a business concern. Errors and frauds arise mostly in connection with receipts and payments of cash by making misappropriations wherever possible. Hence the auditor should see whether all receipts have been recorded in cash book and no fictitious payment appears on the payment side of cash book.

General Points to be considered while Vouching Cash Transactions

The auditor should consider the following general points while vouching the cash transactions:

1. **Internal Check System** : Before starting the vouching of cash book, the auditor should enquire about the internal check system in operation. If there is no well-organized internal check system, there are a lot of chances of misappropriation of cash. He should study carefully the internal check systems regarding cash sales and other receipts.
2. **Examination of Test Checking** : As far as possible, all cash transactions are to be checked elaborately. However, if the auditor is satisfied that there is an efficient internal check system, he can resort to test checking. In such a case, he may check a few items at random and if he finds that they are all in order and free from irregularities, he has reason to assume that the remaining transactions will be correct.
3. **Comparison of Rough Cash Book with the Cash Book** : Usually, cash receipts are entered first in the rough cash book before they are entered in the cash book. The auditor should examine the entries in the rough cash book and main cash book and then compare them to detect whether there is any error or irregularity.

4. **Examine the Method of Depositing Cash Receipts Daily :** The auditor should examine the method adopted for depositing daily cash receipts in bank. The pay in slip should invariably be used for this purpose.
5. **Preparing of Bank Reconciliation Statement :** The auditor should prepare a Bank Reconciliation Statement verifying the bank balance with cash book and pass book and find out the reasons for the difference between the bank balance as per Pass Book and that of in the Cash Book.
6. **Verification of Cash in Hand :** The auditor should verify the cash in hand by actually counting it and see whether it agrees with cash book balance.
7. **Ensuring Proper Control of Receipts Book :** The auditor should see whether receipt books are kept under proper control. While doing so, he should enquire as to whether all receipts are in printed forms, whether counterfoil receipts are used or a system of carbon copy is used, and all receipt books and all receipts are separately and consecutively numbered.

He should compare the particulars as regards to date, amount, name, etc. with cash book entries. If there are certain entries in cash book for which receipts have been issued, they should be carefully checked. The receipts have to be signed by a responsible officer, and not by the cashier.

The unused receipt book should be kept in safe custody with some responsible officials. Along with cash receipt, the rule for granting cash discount should be examined. If there is a system under which a receipt accompanies the receipt of cash, such a receipt, usually known as delivery note should be properly signed and returned to the customer.

Cash Transaction

Cash transactions may be :

- (a) Cash Receipts
- (b) Cash Payments.

Auditor should take the following precautions while vouching cash receipts or cash payments.

4.20 VOUCHING OF CASH RECEIPTS

1. **Opening Balance of Cash Book :** Opening balance of cash book represents cash in hand at the start of the year and should be verified from the balance sheet of last financial year.
2. **Cash Received from Debtors :** Consider the following points for verification of cash received from debtors.
 - ◆ The carbon copies or counterfoils of cash receipt book should be verified.
 - ◆ Cash receipt should be serially numbered.

- ◆ Cash received should be entered on the same date when the cash is actually received.
- ◆ The discount allowed to customers should be properly authorized by a responsible officer.
- ◆ Correspondence with customer and ledger account should be tallied.

Following are the different ways used for misappropriation of cash.

- ◆ Cash received from customer not recorded in books and no cash receipt may be issued.
- ◆ Issuance of receipt for lesser amounts than amount actually received.
- ◆ Using teeming and lading method; it is a very common method to misappropriate the money, in which the cash received from any customer not recorded in the books and the cash received from same customer at a later instance or another customer recorded in the books and so on.

Repayment of Loan by Others : Repayment of loan by others may be verified in the following ways :

- ◆ Calculation of interest received and interest should be credited to interest received account.
- ◆ Verification from bank statement if directly deposited by party into bank.
- ◆ Checking of carbon copies or counterfoils of cash receipts.
- ◆ To ensure that there should be no violation of Income Tax rules as payment of loan exceeding ₹ 20,000/- cannot be repaid in cash. It should be through Cheques, Demand Draft, NEFT, RTGS or any other available banking channels.4.

Rent Received

- ◆ To check rental agreement or lease deed.
- ◆ In case where the rental income is received from more than one property, separate account for each property should be maintained.
- ◆ The Auditor should verify that the rent for all the twelve month is received or not.
- ◆ The amount of rent should be verified from the rent deed or the lease deed.
- ◆ If TDS (Tax Deducted at Source) is deducted by the party, there should be proper accounting of TDS.

Sale of Investments

- ◆ To check bank statement if the sales proceeds have reached the bank account.
- ◆ To verify broker commission, note or debit note, if investments are sold through broker.

- ♦ To ensure separate accounting is being done for capital receipts and revenue receipts. Dividend or profit or loss on sale of investment is a revenue receipt and the sales proceeds of the investment cost should be booked as capital receipt.

6. **Subscription :** Subscriptions are received from the members of a club and the following points need to be considered by the Auditor while vouching subscription :

- ♦ Subscription register should be verified.
- ♦ Verification of subscription received during the year and the subscription receivable.
- ♦ Counterfoil of cash receipt should be verified.

7. **Sale of Fixed Assets**

- ♦ To check minutes of the meetings of the Board of Directors.
- ♦ Sale agreement or sale contract.
- ♦ Verification of agent account if sale is made through an agent.
- ♦ Profit or Loss on sale of fixed assets should be booked to revenue account.
- ♦ Authorization of sale of fixed assets.
- ♦ Sale proceed of fixed assets should be credited to fixed assets account after deducting expenses on sale of fixed assets if any.

8. **Interest and Dividend Received**

- ♦ Verification of the dividend warrant letter along with the covering letter for verification of dividends in case of dividends received through cheque.
- ♦ Verification of bank statement, if the dividend is directly credited to the bank account.
- ♦ Interest on security can be vouched from the securities schedule.
- ♦ Interest on fixed deposit can be verified from bank statement and TDS certificates.
- ♦ Interest received from outsiders to whom company has granted loan could be verified from statement of account of party along with TDS certificates.
- ♦ Provision should be made for interest accrued but not due.
- ♦ All interest received and accrued should be properly accounted for in the books of accounts.

9. **Commission Received**

- ♦ Verification of agreement on the basis of which the commission is received.
- ♦ Calculation of the commission receivable.

- ♦ The commission received should be verified from counterfoils, bank statements, cash receipts, etc. and the provision for commission receivable should be rightly accounted for in the books of accounts.
- ♦ Commission receivable on "sale of goods sent on consignment" should be verified from sale account.

10. Instalments Received on Hire-Purchase Sale

- ♦ Study of the Hire-Purchase agreement for hire-purchase-sale price, number of instalment, rate of interest etc.
- ♦ Segregation of principle amount and interest amount should be done and both should separately account for.
- ♦ Profit on sale on hire-purchase should be duly calculated on the basis of instalment received during the year.

4.21 VOUCHING OF CASH PAYMENTS (CREDIT SIDE OF CASH BOOK)

All the payment made to creditors, expenses incurred in cash and all other payments done appear on the credit side of cash book and the Auditor is required to vouch cash payments because chances of cash misappropriation are very high.

Following points need to be considered for different types of cash payment "

1. **Opening Balance :** The opening balance of cash book can never be credited because cash of company cannot be in negative but the credit bank balance represents the overdraft account from bank or utilization of cash credit limit as sanctioned from bank.
2. **Payment to Creditors :** Payment to creditors may be examined by the following :
 - ♦ Receipt issued by the creditors.
 - ♦ If the creditor is paid amount as full and final settlement, the balance amount, if any stands in the ledger account of the creditor; this amount should be credited to discount received.
 - ♦ If any advance payment is made to creditor that should be clearly mention.
 - ♦ Statement of account of creditor.
3. **Payment of Salaries :** Depending upon the adequacy of internal control system in an organization Auditor will decide his audit Program. It is very important for Auditor to check the following :
 - ♦ Attendance record of employee and salary register.
 - ♦ Appointment letter of new employees.

- ♦ Comparison of current month salary with last month's salary and if there is any abnormal change in amount, Auditor should verify the same.
- ♦ Alteration in amount of deductions on account of advance, loan, fine, funds, insurance, TDS, etc.

4. **Payment of Wages :** At the time of vouching of wages paid, the Auditor should verify the following points to avoid misappropriation of cash :

- ♦ Adequacy of Internal Control System.
- ♦ Payment of wages at higher rate than allowed.
- ♦ Payment shown to ex-workers in the current month.
- ♦ Lower or non-deduction of advance or other deductions due.
- ♦ Payment to fictitious workers.
- ♦ Payment to workers who were absent from duty.
- ♦ Wages sheet should compare with wages register.
- ♦ Comparison of current month wages with last month's wages and proper verification should be there for extra ordinary changes.
- ♦ Detailed verification for payment to casual workers.
- ♦ Vouching and verification of treatment accounting treatment for unpaid wages.

5. **Purchase of Plant and Machinery :** The Auditor should pay attention to the following :

- ♦ Purchase invoice of machinery.
- ♦ Freight inward charges, installation charges, erection and commissioning charges should be capitalized.
- ♦ Treatment of Excise duty according to the excise rules.

6. **Purchase of Land and Building :** Purchase of Land and Building can be vouched as follows :

- ♦ Study of Lease hold agreement, if land is purchased on lease hold basis.
- ♦ Payment should be as per lease term.
- ♦ All the expenses incurred to acquire lease hold property should be debited to respective property account.
- ♦ Auditor should study the conveyance deeds in case property is purchased under free hold basis.

- ◆ For verification of payment, the Auditor can check the payment receipt and the conveyance deed.
7. **Rent Paid :** Consider the following points for the verification of rent by the auditor :
- ◆ Rent Deed.
 - ◆ Rent receipt from Land lord.
 - ◆ Provision for un-paid rent at the end of the year.
8. **Insurance Premium :** Consider the following points for the verification of Insurance Premium:
- ◆ Insurance policy issued by the Insurance Company.
 - ◆ Insurance premium receipt
 - ◆ Insurance premium should not be related to any official of the company.
9. **Income Tax :** Consider the following for the verification of Income :
- ◆ Advance Tax Challan
 - ◆ Self-Assessment Tax challan
 - ◆ Income Tax demand notice
 - ◆ Assessment order
10. **Excise Duty “Consider the following for the verification of Excise Duty :**
- ◆ Rate of Excise Duty
 - ◆ Excise records and sale invoice for verification of excise duty
11. **Commission on Sale :** Consider the following for the verification of Commission on Sale:
- ◆ Agreement of sale.
 - ◆ Rate of commission on sale.
 - ◆ Calculation of commission on the basis of sale.
 - ◆ Cash receipt issued by agent.
 - ◆ Provision for commission payable
12. **Director’s Fees : Consider the following for the verification of Director’s Fees “**
- ◆ Directors receive fees for attending the Board meetings.
 - ◆ Verification of attendance registers.
 - ◆ Verification of payment receipt duly acknowledged by the directors.

Internal Control System for Cash Transactions

Following are the main features of a good internal control system :

- ◆ All cash received should be accounted for immediately.
- ◆ All received cheques should be crossed immediately on receipt.
- ◆ Cash receipt should be issued to debtors and daily reconciliation of account should be done where the debtors pay cash on daily basis.
- ◆ All cash receipts should be deposited in bank on a daily basis.
- ◆ Bank reconciliation account should be prepared on a regular basis.
- ◆ Payments other than petty payments should be done through crossed cheques.
- ◆ Cash receipt should be obtained for every cash payment to creditors.
- ◆ Cash expenses should be duly supported by proper and genuine bills or vouchers.

4.22 VOUCHING OF LEDGER

4.27 CONTINGENT ASSETS

There is no practice of showing these in the balance sheet either as a foot note or any other manner and in Companies Act also there is no provision to show them. It is but fair that if a contingent liability is shown, a contingent asset must also be shown at the same time.

4.28 AUDITING IN EDP ENVIRONMENT

ELECTRONIC DATA PROCESSING

Electronic data processing is a frequently used term for automatic information processing. It uses the computers to manipulate, record, classification and to summarize data. A computer is the best example of an electronic data processing machine. Electronic data processing is an accurate and rapid method.

Electronic data processing (EDP) can refer to the use of automated methods to process commercial data. Typically, this uses relatively simple, repetitive activities to process large volumes of similar information. For example: stock updates applied to an inventory, banking transactions applied to account and customer master files, booking and ticketing transactions to an airline's reservation system, billing for utility services. Electronic information handling or EDP is a quick, secure and hassle-free information preparing framework that can produce any kind of information.

4.29 CHARACTERISTICS OF EDP SYSTEMS

The auditors should understand and consider those characteristics of EDP systems that may have an impact on the accounting system and related internal controls. Such characteristics can be described under the following categories :

1. Organisational Structure
 2. Nature of Processing
1. **Organisational Structure** : In an EDP environment an entity will establish an organisational structure and procedures to manage the EDP activities.

Characteristics of an EDP organisational structure include :

- (a) **Concentration of Functions and Knowledge** : Although most systems employing EDP methods will include certain manual operations, generally the number of persons involved in the processing of financial information is significantly reduced. Furthermore, certain EDP personnel may be the only ones with a detailed knowledge of the source of data, the methods of processing and the distribution and use of the output. It is also likely that they are aware of the internal controls present and, therefore may be in a position to alter computer programs or data while stored or during processing. Many conventional controls based on adequate segregation of duties may not exist or may be less effective, constituting an additional risk that fraud and error may not be detected.

- (b) **Concentration of Data** : because of the nature of computer processing, data relating to the entity may be concentrated in one department (i.e., the EDP department). Therefore, in the absence of appropriate controls, there is an increased risk of unauthorised access to, and alteration of, such data.

2. **Nature of Processing** : The use of computers will involve methods of recording and processing which are significantly different from manual systems. Two fundamental characteristics of computer systems give rise to these differences :

- (a) the operation of computer programs, and
(b) the recording and storage of data in machine readable form.

The operation of computer programmed procedures has the following effects :

- (a) **Consistency of Performance** : EDP systems perform functions exactly as programmed and are potentially more reliable than manual systems, provided that all transaction types and conditions that could occur are anticipated and incorporated into the EDP system. A computer program that is not correctly programmed and tested may be unreliable and may consistently process transactions or other data erroneously
- (b) **Control Procedures** : It is now common that controls exercised by users will usually be integrated with the operation of programmed procedures and in some cases will be replaced by them. This can provide difficulties for auditors in adequately testing the control procedures, particularly where there is a lack of visible evidence.
- (c) **System Integration** : A single input to the EDP, system may automatically update all records associated with the transaction. For example, a shipment of goods entry may update the sales and customer accounts receivable file as well as the inventory file. An erroneous entry in such a system may create errors in several financial accounts.
- (d) **Systems Generated Transactions** : certain transactions may be initiated by the EDP system and may not be evidenced by hard copy documentation. In addition the authorisation of such transaction may not be specifically documented in the same way as for transactions which are initiated outside the EDP system. For example, interest may be calculated and charged automatically to customers account balances on the basis of pre-authorised terms contained in a computer file, or assets may be transferred from one entity to another on the basis of pre-recorded instructions.
- (e) **Lack of Hardcopy Evidence** : since one of the prime objectives of an EDP system is to reduce the amount of detailed work to be carried out by the user this will often result in an absence of printout detailing processing of every transaction. Similarly data are often entered directly into the EDP system without supporting documentation,

and with authorisation controls being contained in computer programs (e.g., credit limit approval).

The recording and storage of data in machine readable form has the following effects:

- (a) **Accessibility of Data and Computer Program** : data and computer programs can be directly accessed and altered (e.g. through the use of on-line terminals). Therefore in the absence of appropriate controls there is an increased risk of unauthorised access to and alteration of, data and computer programs by persons inside or outside the entity.
- (b) **Transient Nature** : part of the transaction trail may be stored only in machine readable form or may exist only for a limited period of time.
- (c) **Vulnerability of Data and Program Storage Media** : the physical characteristics of machine readable media, such as magnetic disks and tapes, make them more vulnerable to theft, loss, or intentional or accidental destruction.

4.30 INTERNAL CONTROLS IN AN EDP ENVIRONMENT

The internal controls over computer processing, which help to achieve the overall objectives of internal control, include both manual procedures and procedure designed into computer programmes. Such manual and computer controls affect the EDP environment (General EDP Control) and the specific controls over the accounting applications (EDP Application Controls). EDP means (Electronic Data processing) for the audit or a computer based systems. For audit process of enterprise.

- I. **General EDP Controls** : The purpose of general EDP controls is to establish a framework of overall control over the EDP activities and to provide a reasonable level of assurance that the overall objectives of internal control are achieved. These controls may include.
 - a. Organization and management control are designed to establish an organizational framework over EDP activities, including :
 - i. Policies and procedures relating to control functional.
 - ii. Appropriate segregation of incompatible functions.
 - b. Application systems development and maintenance controls are designed to establish control over :
 - i. Testing, conversion, implementation and documentation of new or revised system.
 - ii. Changes to application systems.
 - iii. Access to system documentation
 - iv. Acquisition of application systems from third parties

- c. Computer operation controls are designed to control the operation of the systems and to provide reasonable assurance that :
 - i. The systems are used for authorized purposes only
 - ii. Access to computer operations is restricted to authorized personnel.
 - iii. Only authorized programs are used.
 - iv. Processing errors are detected and corrected.
- d. Systems Software Controls include :
 - i. Authorization, approval, testing, implementation and documentation of new systems software and systems software modifications.
 - ii. Restrictions of access to systems software and documentation to authorized personal.
- e. Data entry and program controls are designed to provide reasonable assurance that :
 - i. An authorization structure is established over transactions being entered into the system.
 - ii. Access to data and programmes is restricted to authorized personal.
 - iii. Offsite back-up of data and computer programmes.
 - iv. Recovery procedures for use in the event of theft, loss or intentional or accidental destruction.
 - v. Provision for offsite forecasting in the event of disaster.

EDP APPLICATION CONTROLS

The purpose of EDP application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorized and recorded; and are processed completely, accurately and on a timely basis. These include :

- (a) Controls over input are designed to provide reasonable assurance that :
 - Transactions are properly authorized before being processed by the computer.
 - Transactions are accurately converted into machine, readable from and recorded in the computer data files.
 - Transactions are not lost, added, duplicated or improperly changed.
 - Incorrect transaction is rejected, corrected and if necessary, re submitted on a timely basis.
- (b) Controls over processing and computer data files are designed to provide reasonable assurance that :

Transactions, including system generated transactions are properly processed by the computer.

Transactions are not lost; added; duplicated or improperly changed.

Processing errors are identified and corrected on a timely basis.

(c) Controls over output are designed to provide reasonable assurance that :

Results of processing are accurate.

Access to output is restricted to authorized personnel.

Output is provided to appropriate authorized personnel on a timely basis.

4.31 DIFFERENT DESIGNS AND PROCEDURAL ASPECTS OF EDP SYSTEMS

The different design and procedural aspects of EDP systems are :

1. **Consistency of Performance :** EDP systems performs functions exactly as programmed and are potentially more reliable than manual systems.
2. **Programmed Control Procedures :** The nature of computer processing allow the design of internal control. Procedures in computer programmes. These procedures can be designed to provide controls with limited visibility (protection of data against unauthorized access may be provided by passwords), use with manual intervention, review of reports printed for exception and error reporting, and reasonableness and limit checks of data.
3. **Single Transaction Update of Multiple or Data Base Computer File :** A single input to the accounting system may automatically update all records associated with the transaction.
4. **System Generated Transactions :** certain transactions may be initiated by the EDP system itself without the need. For an input document the authorization of such transaction may neither be supported by visible input documentation nor documented in the same way as transactions which are initiated outside the EDP system.
5. **Vulnerability of Data and Programme Storage Media :** Large volumes of data and the computer programmes used to process such data may be stored on portable or fixed storage media, such as magnetic discs and tapes. These media are vulnerable to theft or intentional or accidental destructions.

4.32 ASSISTED COMPUTER TECHNIQUES REQUIRED IN EDP AUDIT

The use of computer may result in the design of systems that provide less visible evidence than those using manual procedures. CAATs are such techniques applied through the computer which are used in the verifying the data being processed by it. System characteristics resulting from the nature of EDP processing that demand the use of computer assisted audit techniques are:

1. Absence of input documents
2. Lack of visible transaction trail

3. Lack of visible output
4. Absence of appropriate control
5. Unauthorized access to data and computer programmes.

Advantages of CAATs

Audit effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence for example –

1. Some transactions may be tested more effectively
2. Applying analytical review procedures.
3. An auditor can save the time
4. Effective test checking and examination in depth.