

State Audit Institution (SAI)- Sultanate of Oman

**Audit Manual For Governmental Authorities, Public
Establishments And Companies**

2015

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1. Introduction

The following Audit Programs for Governmental entities included guidance for reporting, and disclosures.

These Audit Programs are being issued to assist (i) Governmental entities in preparing their financial statements in accordance with Financial Reporting Standards, applicable laws and regulations and (ii) SAI Auditors in auditing them in accordance with generally accepted government auditing standards (GAGAS).

The Audit Programs provides a systematic, organized, and structured approach to preparing or reviewing Governmental entity financial statements. While the questions contained in the checklist are taken from authoritative sources, the checklist itself is not authoritative, nor is it comprehensive. Preparers and auditors may also consult financial management regulations and policies for their individual entity, as these regulations and policies may have guidance when standards allow alternatives or management flexibility, such as for property capitalization limits.

These audit programs would be mostly used for the government companies, however they can be tailored to be used for Ministries and other governmental entities.

2. Audit Programs

2.1 Investment

The principal objectives in auditing investments and the related investment income are to determine whether:

- All recorded investments on the balance sheet are held by the entity or by custodians for the entity, and that all investment are free from detention, mortgage or other guarantees (Existence financial statement assertion).
- All recorded income from investments has accrued to the entity at the balance sheet date, (Existence financial statement assertion).
- All investments owned by the entity at the balance sheet date are included on the balance sheet. All income accruing from investments at the balance sheet date has been recorded, (Completeness financial statement assertion).
- Investments are included on the balance sheet at the appropriate amounts. Investment income is stated on the income statement at the appropriate amount, (Valuation financial statement assertion).
- The entity owns, or has a legal right to, the investments included on the balance sheet. All investments are free of liens, pledges, or other security interests or, if not, such liens, pledges, or other security interests are identified, (Rights and Obligations financial statement assertion).
- Investments and related investment income accounts are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.1.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures (“Perform Analytical and Data Analysis Procedures”):

- Compare the account balances with those of prior periods and investigate any unexpected changes (or the absence of expected changes).
- Compare current year’s to prior year’s market value of the security.
- Perform an overall test of the reasonableness of interest income by multiplying the average interest rates by the average amounts invested.

B. Tests of Details (“Perform Tests of Details”):

Negative results from performing such procedures could indicate matters requiring further investigation):

- Note evidence of unusual investment transactions (e.g., churning or high risk securities).
- Discuss with the entity procedures used to determine whether a decline in market value of investments is other than temporary.
- Determine if any decline in market value of investments below cost is other than temporary by performing some or all of the following procedures:
 - Reviewing the issuer’s most recent audited financial statements;
 - Considering the time and the extent to which the market value has been less than cost;
 - Considering the issuer’s near-term prospects, including any specific events that may influence the operations of the issuer;
 - Determining if decline in market value relates to cyclical patterns of the issuer’s industry or is reflective of a prolonged decline in the specific industry;
 - Comparing movements in the issuer’s market value to patterns in the issuer’s industry and the general market;

- Comparing movements in market value for similar investments;
- Determining if the entity has the intention and ability to retain the investment for a period sufficient to allow for any anticipated recovery in market value;
- Reviewing realized and unrealized losses subsequent to the balance sheet date;
- Reviewing changes in issuer's market value subsequent to the balance sheet date.
- Determine that the write down of an investment to a new cost basis as a result of a decline in market value that is judged to be other than temporary is accounted for as a realized loss. Also, test calculation of the loss recorded.
- Determine that the new cost basis of investments previously written-down is not changed for subsequent recoveries in market value.
- Review a summary of investments written-down for completeness and unusual items.
- Conclude on the adequacy of impairment adjustments recorded.
- Verify computations of gains and losses from sales of investments.
- Verify calculation of amortization of bond premium or accumulation of bond discount.
- Consider specialized industry practices.

C. Procedures to consider with respect to repurchase agreements

- Confirm terms of outstanding repurchase commitments. Terms should include the types and coupon rate of collateral and the repurchase date and prices.
- Determine the reputation and reliability of collateral holders. These holders should be recognized banks or trust companies that are independent of the broker/dealer arranging the transaction and that specialize in providing safekeeping services.
- Review the reputation and financial position of broker/dealers or other parties to the transactions.
- Determine the financial credibility and legal responsibility of any company or entity that is insuring completion of the transaction.
- Review broker's advices and other documentation regarding the completion of repurchase transactions during the period subsequent to the balance sheet date.
- When applicable, determine the legality of transactions and their compliance with established policies and applicable regulatory guidelines.
- Review and evaluate internal audit procedures covering repurchase agreement activities.

D. Additional procedures to consider when an entity is a buyer-lender (and surrendered possession of the securities)

- Examine securities held or request a confirmation of securities held in safekeeping and determine who holds legal title to securities.
- If a custodian is of uncertain or questionable reputation and reliability, obtain a third-party review or perform procedures with respect to controls over the safekeeping of the security by the custodian.
- Determine collateral value of securities.

E. Specific procedures (procedures that provide assurance for particular audit objectives):

- Verify the existence and ownership of recorded investments through confirmation or examination of evidence of ownership (e.g., stock certificates).
- Review minutes, agreements, and confirmation replies for evidence of the existence of investments; of liens, pledges, or other security interests in investments; and of commitments to acquire or dispose of

investments.

- Inspect market quotations, financial statements of investees, and other evidence of the current value or equity amount of investments.
- Determine that investments are carried at the appropriate amounts. Detailed procedures which may be performed are listed under “General procedures” below.

F. Other procedures responsive to the evaluation of routine data processes:

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when the auditor has evaluated the controls as “effective” and tested them and found that SAI can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The SAI auditors should consider performing these types of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is “moderate” or “high” since in such circumstances they would have assessed inherent risk as higher), and are more likely to perform them when SAI have evaluated the controls as ineffective, particularly when they have assessed the combined risk as high.

- Verify the existence and ownership of recorded investments through confirmation or examination of evidence of ownership (e.g., stock certificates).
- Review minutes, agreements, and confirmation replies for evidence of the existence of investments; of liens, pledges, or other security interests in investments; and of commitments to acquire or dispose of investments.
- Inspect market quotations, financial statements of investees, and other evidence of the current value or equity amount of investments.
- Determine that investments are carried at the appropriate amounts. Detailed procedures which may be performed are listed under “General procedures” below.

The timing and extent of procedures performed are responsive to the risk assessment.

Cash receipts and cash disbursements applications:

- Verify interest and dividend income, and equity in equity in earnings (losses) of investees, by calculating interest earned or by referring to published records of dividends paid or to the financial statements of investees.
- Inspect brokers' advices and other support to verify that additions and disposals have been recorded properly.
- Review the investments and related accounts (e.g., interest and dividend income) in the general ledger for unusual items.
- Determine whether investments are appropriately classified as non-current assets.

2.1.2 GUIDANCE SUPPLEMENTING ILLUSTRATIVE PROCEDURES

I. Considerations

In planning the examination of investments, SAI should consider IAS No. 39, "Financial Instruments: Recognition and Measurement" or the appropriate standards when a designated country's accounting standards are being applied and the requirements of Part D of ISA 501 pertaining to valuation and disclosure of long-term investments. SAI should also consider the fact that certain industries have specialized accounting and auditing practices for investments that are described in authoritative sources available in the Sultanate and other countries. The following information does not deal specifically with those industries. SAI should refer to those pronouncements and any firm-developed industry supplements when they apply to the entity's industry.

II. Verification of Existence

When SAI inspect investments, they usually do it at the same time as they count cash and other negotiable assets. If those assets cannot be counted at the same time, SAI use other control procedures that will prevent the substitution of one type of negotiable asset for another. When inspecting investments, SAI should observe:

- The exact names of the issuers
- The descriptions of the securities
- The name(s) of the indicated owner(s) of the securities
- Any evidence of pledging or restrictions on disposal shown on the certificates
- The certificate numbers on the documents, and
- The number of shares of stock or face value of debt securities. When confirming investments held by custodians or depositories, the auditors should request information that is generally comparable to that obtained when inspecting securities. The auditors should also consider the financial responsibility of outside custodians or depositories.

The physical count or confirmation of investments may be performed at an interim date if internal controls are evaluated as effective. Among the indications of effective internal control are:

- Maintenance of detailed security records, including certificate numbers, by personnel not having access to or control over the securities themselves;
- Issuance of securities in the entity's name; and
- Use of an independent custodian or depository to safeguard the securities.

III. Classification

When SAI reviews the appropriateness of classifying an investment as a non-current asset, they should recognize that classification is largely dependent on management's intention to hold the investment (for example, to ensure a source of supply for raw materials) and the marketability of the investment. SAI should corroborate management's intention by evaluating whether a non-current classification is reasonable in the light of the entity's financial position, working capital requirements, debt agreements, and any other contractual obligations. SAI should also obtain representations from management of its intention to continue to hold such an investment as a long-term investment.

If the entity's needs make it likely that the investment will be sold to raise working capital, SAI should consider whether the investment should be classified as a current asset.

In the case of an unclassified balance sheet, SAI should consider whether the entity's operational needs or intentions will result in the disposal of the investment within one year of the balance sheet date. If there is evidence indicating that investments will be disposed of within one year, the discussion of the carrying amount for marketable securities earlier in this chapter ("Marketable Securities") is applicable.

IV. Carrying Amount

SAI should consider marketable equity securities separately from other securities and determine whether:

- The portfolio of marketable equity securities has been properly aggregated;
- Any valuation allowance required has been properly computed; and
- Changes required in the valuation allowance have been appropriately accounted for.

With respect to other investments, SAI should evaluate whether the entity has chosen the appropriate method of accounting and whether the method chosen has been properly applied.

Where the equity method of accounting or consolidation (IAS No. 27, "Consolidated Financial Statements and Accounting for Investments in Subsidiaries") is appropriate, the auditor normally obtain audited financial statements of the investee or subsidiary and evaluate those financial statements or other available evidential matter to support the carrying amount of the investment and changes therein.

The auditor should pay particular attention to the assigned market value in situations where market quotations may not be a reliable indicator (e.g., where the stock is closely held or thinly traded) and where market quotations are not available (e.g., for a privately held company).

The auditor should consider the need for disclosure of realized and unrealized losses arising after the balance sheet date.

V. Decline in Market Value Other than Temporary

The auditor should evaluate all securities (whether equity or debt, current or non-current) whose market value is less than cost at the balance sheet date to determine whether the decline in market value is other than temporary (often referred to as a "review for permanent impairment of value").

Determining whether or not a decline in market value below cost is temporary in nature or is reflective of conditions that are more persistent requires the exercise of judgment. In making that determination, the auditor should consider all the information necessary to evaluate the entity's ability to ultimately recover the carrying amount of the investment, including whether:

- The decline in market value is attributable to specific adverse conditions for a particular security (in this situation, a write-down in carrying amount is required unless persuasive evidence exists to support the carrying amount);
- The decline in market value is attributable to general market conditions that reflect the prospects of the economy as a whole or of a particular industry (this situation may or may not be indicative of the entity's ability to ultimately recover the carrying amount);
- The investment has a fixed maturity date (decline in market value of bonds, preferred stock with mandatory redemption, and similar investments may be considered temporary unless evidence indicates that they will be disposed of before maturity or that their carrying amount may not be realized when they are due); and
- Realized or unrealized gains or losses have occurred after the balance sheet date (to be considered in evaluating whether a write-down is required at the balance sheet date).

In addition, evidence of loss in value of a security accounted for by the equity method might include, but would not necessarily be limited to, the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment. However, a decline in quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is other than temporary. All are factors to be evaluated.

If SAI conclude that the available evidence does not support either a judgment that the carrying amount will eventually be recovered or a judgment that the decline is other than temporary, the continued existence of a decline in market value is indicative of an uncertainty to be considered in the auditors' report.

2.1.3 Documentation

Documentation includes, but is not limited to, identification of the following:

- The procedures performed (generally the audit program or reference to it) and conclusions reached with respect to the procedures performed, together with a statement of overall conclusions with respect to investments;
- The relationship of the nature, timing, and extent of procedures performed to the evaluation of accounting estimation, routine data, and non-routine data processes, or reference to the documentation of such relationship elsewhere in the audit working papers (usually in the planning documents);
- The problems encountered and bases of resolution; and
- To the extent appropriate, the following:
 - Summary of investments and related accounts, and activity in those accounts during the period;
 - Business reasons for additions and disposals;
 - Plans or commitments for future acquisitions or disposals of investments;
 - List of investments physically counted or confirmed;
 - Confirmation replies;
 - Details of cost, equity in investee, market value, and evidential matter supporting the carrying amount of each investment;
 - Results of analytical review procedures performed; and
 - Details of liens, pledges, security interests or restrictions on the use or disposal of investments.

2.2 Accounts Receivables

The principal objectives in auditing accounts receivable are to determine whether:

- All receivables on the balance sheet are real claims of the entity, (Existence financial statement assertion).
- All real claims of the entity for amounts receivable are included on the balance sheet, (Completeness financial statement assertion).
- Receivables are carried at their net realizable (collectible) value (i.e., the gross receivables are properly stated with appropriate allowances provided for uncollectible accounts, discounts, returns, warranties, and similar items), (Valuation financial statement assertion).
- The entity owns, or has a legal right to, all the receivables on the balance sheet at the balance sheet date. All receivables are free of liens, pledges, or other security interests or, if not, such liens, pledges, or other security interests are identified, (Rights and Obligations financial statement assertion).
- Receivables are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.2.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures, “Perform Analytical and Data Analysis Procedures”:

- Compare the aged listing of accounts receivable with those of prior periods and note any significant changes (e.g., changes in major customers, in major customers’ balances in the percentage of overdue accounts, in the proportion of credit balances, etc.).
- Compare the current period’s accounts written off and the allowance and provision for doubtful accounts as percentages of accounts receivable and sales with prior periods’ percentages. Evaluate trends in light of current economic conditions.
- Compare current year’s to prior year’s allowance for doubtful accounts as a percentage of (a) accounts receivable and (b) sales.
- Compare the current period’s receivables as a percentage of net sales with prior periods’ percentages, and consider the reasonableness of the current period’s percentage in relation to current economic conditions, credit policies, collectability, etc.
- Compare the current period’s accounts receivable turnover and number of day’s sales outstanding with prior amounts, and consider the reasonableness of the current period’s amounts in relation to current economic conditions, credit policies, collectability, etc.
- Compare the aging with the entity’s and with the industry’s collection practices.
- Compare the current period’s sales returns and sales discounts as percentages of sales by product line with prior periods’ percentages. Investigate significant fluctuations.
- Compare the current period’s allowance for unissued credits as a percentage of total credits issued and accounts receivable with prior periods’ percentages. Investigate significant fluctuations.
- Compare the number and amounts of credits issued with those of prior periods.

B. Tests of Detail (“Perform Tests of Details”):

Negative results from performing such procedures could indicate matters requiring further investigation):

➤ Accounts receivable

- Review evidence or obtain information concerning credit worthiness for large new accounts.
- Trace the totals of accounts receivable in the customers’ ledgers to the general ledger control accounts or accounts receivable summary; investigate reconciling items.

- Inquire about management, salespersons, or others receiving products without billing or payment.
- For large or unusual sales contracts uncompleted at year end, request confirmation from customers as to pricing, discount, payment, and warranty terms.

➤ **Notes receivable**

- Review a summary of notes receivable and the related interest accounts and examine the activity in them during the period with respect to large balances arising other than in the normal course of business; determine that amounts are properly classified.
- Inspect notes receivable, including any collateral and any guarantee held; determine that necessary disclosures are made.
- Confirm notes receivable, including any collateral and any guarantees held; determine that necessary disclosures are made.
- Verify accrued interest at the balance sheet date and interest earned during the period.

➤ **Allowances**

- Determine rights of return offered to customers under the terms of sales agreements or as a matter of practice.
- Review analysis of activity in the allowance for uncollectible accounts and bad debt expense accounts during the period.
- Evaluate the adequacy of the allowance for uncollectible accounts at the balance sheet date.
- Review analysis of activity in the allowances for discounts, returns, warranties, and similar items during the period.
- Evaluate the adequacy of the allowances for discounts, returns, warranties, and similar items at the balance sheet date.
- Test the accuracy of the accounts receivable aging by tracing details to and from the customers' ledger accounts or supporting documentation. Test aging for clerical accuracy.
- Evaluate the adequacy of any collateral and guarantees on notes receivable.
- Request confirmation of accounts written-off during the period.
- Review payments received subsequent to the balance sheet or confirmation date.

C. Other Common Procedures

- Test the timing and amount of year-end revenue recognition by tracing to long-term contracts, service agreements, license agreements, or other appropriate documentation to detect errors and/or estimate amount of incorrect revenue recorded. Review year-end cost and progress estimation procedures. Determine that revenue recorded under "bill and hold" agreements results only from accommodations to customers under normal credit terms; confirm that title has passed at the date of revenue recognition.
- Examine details of accounts or notes receivable from officers, directors, shareholders, and other related parties; investigate unusual items as well as significant reductions or increases at the balance sheet date; determine that necessary disclosures are made.
- Obtain listings of receivables sold with recourse; confirm with both the debtors and the person or entity owning or having rights in the receivables; evaluate contingencies arising from such sales; determine that necessary disclosures are made.
- Review minutes, loan agreements, and other documents for evidence of liens, pledges, or other security interests in receivables; determine that necessary disclosures are made.

D. Confirm accounts receivable.

If accounts are confirmed at an interim date, review the "roll-forward" of activity from the confirmation date to the balance sheet date and compare level of activity with prior periods.

Investigate unusual items; consider confirming (at the balance sheet date) significant new accounts and those accounts with significant increases or decreases between the confirmation date and the balance sheet date.

Examine subsequent cash receipts, shipping records, sales contracts, and other evidence to verify the validity of accounts receivable for which replies to confirmation requests are unsatisfactory or were not obtained or as part of supporting year-end receivables balances.

Test the cutoff by inspecting the sales register, billings, shipping documents, and other supporting documents immediately before and after the cutoff date, and determine that the transactions were recorded in the proper period; compare the receivables cutoff to cutoffs in related areas (e.g., sales and inventories).

Evaluate the adequacy of the allowance for doubtful accounts. Example procedures that may be performed are listed under “General Procedures” below.

E. Other procedures responsive to the evaluation of routine data processes

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when SAI has evaluated the controls as “effective” and tested them and found that SAI can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. SAI should consider performing these types of procedures when it has evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is “moderate” or “high” since in such circumstances SAI would have assessed inherent risk as higher), and are more likely to perform them when SAI has evaluated the controls as ineffective, particularly when SAI has assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

➤ Sales application

- Account for the numerical sequence of sales invoices, sales orders and shipping documents during a specified period. Reconcile billings with shipping documents for a substantial portion of the period.
- Test the records of products ordered and shipped to the sales records; agree dates, customers, products, quantities, prices and amounts.
- Test the posting of individual sales invoices to the sales register and to the customers’ ledger.
- Test recorded sales to the records of products ordered and shipped; agree dates, customers, products, quantities, prices and amounts.
- Review the listing of accounts receivable and investigate unusual balances, credit balances, and accounts that may not be accounts receivable or may not be properly classified as accounts receivable-trade (e.g., consignment accounts, related party or employee accounts).
- Investigate large or unusual credit memos issued subsequent to the balance sheet date.
- Test the pricing and mathematical accuracy of sales invoices.
- Test the accounting classification of sales transactions.
- Review the accounts receivable, sales, and returns and allowances accounts in the general ledger for unusual items.
- Review the sales register, the sales returns and allowances register, and the cash receipts register for unusual items; investigate any such items observed.
- Test the mathematical accuracy of the sales register.
- Trace the accounts receivable to the customers’ ledgers; investigate reconciling items.
- test the postings of the totals in the sales register to the general ledger and the customers’ ledger.

➤ Sales returns and allowances (credit memos) application

- Compare credit memos and supporting documents with the sales returns and allowances register as to dates, customers, products, quantities, prices and amounts.
- Account for the numerical sequence of credit memos during a specified period.
- Test the posting of individual credit memos to the sales returns and allowances register and to the customers' ledger.
- Compare recorded credit memos with the documents supporting returns and allowances as to dates, customers, products, quantities, prices and amounts.
- Test credit postings in the customers' ledger to the cash receipts ledger or approved credit.
- Test the authorization of credits, discounts and allowances shown in the cash receipts register.
- Test the pricing and mathematical accuracy of credit memos (e.g., trace information to terms and recording of original sales).
- Test the cutoff in processing credits and allowances granted to customers by examining credit memos issued and recorded before and after year end.
- Test the timeliness with which credits granted to customers are processed.
- Test the accounting classification of credit memos.
- Test the mathematical accuracy of the sales returns and allowances register.
- Test the postings of the totals in the sales returns and allowances register to the general ledger and the customers' ledger.

➤ **Cash receipts application**

- Compare remittance advices or lists of cash receipts with the entries in the cash receipts register as to date, remitter, amount and account distribution.
- Compare the details of duplicate deposit slips with the entries in the cash receipts register. Investigate abnormal delays in depositing cash receipts.
- Compare the total amounts of the daily deposits shown on the bank statements with the totals of the daily cash receipts shown in the cash receipts register. Investigate unusual delays in depositing cash receipts and any splitting of daily cash receipts into separate deposits.
- Compare the entries in the cash receipts register (e.g., date, remitter, amount and account distribution) with the remittance advices, lists of cash receipts, duplicate deposit slips and bank statements.
- Test the accounting classifications of cash receipts.
- Test the mathematical accuracy of the cash receipts register.
- Test the postings of the totals in the cash receipts register to the general ledger, customers' ledger and other subsidiary ledgers.
- Test the posting of individual cash receipts from the cash receipts register and supporting documents to the customers' ledger.
- Examine the entity's bank reconciliations (or prepare the reconciliations). When appropriate, e.g., to determine whether receipts or disbursements are recorded on a timely basis, or to verify the appropriateness of reconciling items, obtain cutoff bank statements.
- Test cutoff of cash receipts, disbursements, and transfers at the balance sheet date.

2.2.2 GUIDANCE SUPPLEMENTING ILLUSTRATIVE PROCEDURES

I. Considerations

This section deals with current receivables; long-term receivables are discussed later in this chapter under “Long-Term Receivables, Non-Current Deposits, and Other Assets.”

In planning the audit of receivables, SAI should consider the fact that certain types of receivables (e.g., receivables of contractors) require specialized accounting, auditing, and reporting considerations. The following information does not deal specifically with such specialized situations.

II. Confirmation of Receivables

Confirmation of accounts receivable, which include loans made by a financial institution, is a generally accepted auditing procedure.

In many situations, both confirmation of accounts receivable and other substantive tests of details are necessary to obtain the needed audit assurance.

When the auditor has not requested confirmations in the examination of accounts receivable, he should document how he overcame the presumption.

In planning the timing and extent of confirmation of receivables, the auditor should consider, in addition to the effectiveness of controls, such matters as:

- The possibility of disputes, inaccuracies, or irregularities in the accounts;
- The probabilities that requests will receive consideration and that debtors will be able to confirm the information requested; and
- The materiality of the amounts involved.

The auditors should send confirmations for only as many accounts and monetary amounts as they need to reach a conclusion on the receivables balance. They should also consider confirming some closed or zero balance accounts and some accounts with credit balances.

This section discusses additional considerations when the auditors plan to use confirmation as a specific audit procedure.

SAI should use the positive confirmation method when individual balances are relatively large or when there is reason to believe that accounts may be in dispute or may contain inaccuracies or irregularities.

The negative confirmation method may be used in certain circumstances.

Requests are accompanied by detailed information sufficient to enable customers to reply; this is often accomplished by including an itemized statement with the confirmation request. If the nature of the entity's business or customers (e.g., government, or other customers not maintaining detailed records by supplier) is such that the customers may be unable to reply to requests for confirmation of account balances, SAI should consider confirming specific transactions rather than account balances or including with the confirmation requests additional information (e.g., customers' purchase order numbers) to facilitate the customers' responses.

SAI may encounter unusual or complex transactions, or circumstances or evidence establishing or suggesting that terms granted to customers differ from the terms shown in the entity's records (for example, SAI may encounter evidence of oral modifications to agreements, such as unusual payment terms or liberal rights of return). When SAI believes there is a moderate or high degree of risk that there may be unrecorded significant modifications to terms granted to customers, it should consider requesting customers to confirm both the terms of sale and whether any modifications exist. SAI should make such requests of all customers to whom requests for confirmation of balances are sent, or to a group (presumably smaller) of selected customers. The requests are made in separate letters because persons responsible for responding to requests for confirmation of balances ordinarily are not knowledgeable about terms of purchase.

Entities may transfer receivables to others with or without recourse for non-collection from customers (e.g., they discount or factor their receivables). Although there are many types of arrangements under which receivables are transferred, and a number of variations within each type, the transferor of receivables with recourse retains the risk of loss from non-payment by its customers. To obtain satisfaction regarding any loss contingency, SAI should confirm with the transferees the amounts not yet collected with respect to receivables transferred with recourse. In addition, SAI should often confirm the receivables directly with the customers. SAI should also consider the need to confirm receivables transferred with recourse that have been recognized as sales in accordance with International Accounting Standards for financial instruments (or the designated country's accounting standards applied by the entity).

Accounts selected for confirmation but not mailed at the request of the entity are examined by alternative procedures after considering and investigating the entity's reasons; such requests may be indicative of collectability problems, disputed items, or irregularities in the account balances. SAI should also consider the implications of any restrictions on the confirmation process imposed by the entity. SAI should also consider whether any restrictions on the confirmation procedures are significant enough to constitute a limitation on the scope of the audit.

III. Confirmation Responses

Confirmation of individual accounts normally serves as a test of the existence of the aggregate amounts due from customers and accordingly, errors noted on individual requests are considered in evaluating the total balance of accounts receivable.

Conditions which frequently result in the reporting of confirmation exceptions include in-transit items (e.g., payments made but not received, goods shipped but not received), disputed sales terms, credits allowed but not reflected in the records, and clerical errors. When significant or numerous differences are revealed by confirmation responses, SAI should consider whether further communications with these or other customers, or other auditing procedures, are required.

IV. Procedures in Lieu of Requesting or Obtaining Confirmations

When confirmation requests are not sent or replies are not received, SAI should use such procedures as are necessary to obtain evidence of the existence of the accounts receivable. SAI should consider whether such alternative procedures are sufficient to provide them with the needed audit assurance to permit the auditors to issue an unqualified opinion (as to scope) on the financial statements.

Alternative procedures for accounts receivable include the examination of subsequent collections and tests of charges and credits to the accounts. SAI perform tests of charges by inspecting evidence of sales such as contracts, shipping advises, bills of lading, and freight bills; SAI should perform tests of credits by referring to remittance advises, deposit slips, bank statements, and cash receipts records. SAI should recognize that, unless it sees evidence supporting the pre-year-end date on the items represented by the payment on the account, the subsequent collection of an account does not necessarily mean that the receivable existed at the balance sheet date; it only means that the receivable existed at some time.

V. Roll-Forward Procedures

When receivables are confirmed or otherwise verified at an interim date, SAI should (1) review an analysis of the activity (roll-forward) in the receivable control accounts, along with supporting details (e.g., journal entries), from the interim date to the balance sheet date; and (2) perform detailed tests of the intervening transactions if deemed necessary. SAI should consider confirming or otherwise verifying significant new accounts and those with significant increases or decreases between the interim date and the balance sheet date.

VI. Cut-Off

In reviewing cut-off procedures for receivables, SAI obtain familiarity with the related accounting systems and the manner in which deviations from the norm are handled. When receivables are confirmed or otherwise verified at a date other than the balance sheet date, SAI should generally test the cut-off at both dates and correlate the receivables cut-off with cut-off work in related areas (e.g., sales and inventory)

VII. Bill-and-Hold Transactions

During the procedures, the auditors should be alert for any bill-and-hold transactions that have been improperly recognized as sales. For example, if the entity bills the customer prior to the shipment of the items without specific instructions from the customer, this should not be recorded as a sale. A sale is generally recognized only when the earnings process is complete or virtually complete and an exchange has taken place.

VIII. Allowance for Uncollectible Accounts

Although the procedures described provide assurance about the existence of receivables, they do not ensure collectability. Therefore, the auditors should perform other procedures to assess the collectability of receivables and the adequacy of the allowance for doubtful accounts.

The auditors should evaluate the reasonableness of the entity's process for establishing the allowance for uncollectible accounts by performing a review and evaluation of that process. The review and evaluation includes:

- Obtaining a general understanding of the process;
- Considering the reasonableness of the entity's policies regarding additions to the allowance and write-offs of uncollectible accounts;
- Discussing with management the key assumptions regarding collectability and evaluating the reasonableness of the assumptions;
- Considering the effectiveness of the controls over the data used in the process and of the entity's practices for enhancing the reasonableness of the calculation of the allowance, and
- Evaluating the entity's method of calculating the allowance (i.e., of applying its policies).

Usually, the auditors should also test the application of the policies, discuss with management the collectability of accounts, review credit files and other supporting documentation, and consider the results of other audit procedures (e.g., confirmations, reviews of subsequent collections, tests of aging).

Factors that the auditors should consider in evaluating collectability include:

- The age of the receivables, understanding the entity's customary terms of sales, the conditions under which goods may be returned, and how collections and credit memos are applied to outstanding balances;
- The soundness of the entity's credit granting and collection procedures;
- Collection experience subsequent to the balance sheet date;
- Historical bad debt experience;
- Comparative statistics for the current period and prior periods, such as the relationships of accounts written off and the allowance and provision for doubtful accounts to accounts receivable and sales; and
- Conditions and trends in the industry and the economy in general.

When the adequacy of the allowance for uncollectible accounts is evaluated at an interim date, the auditors should perform roll-forward procedures similar to those described above for the receivable control accounts.

IX. Allowances for Discounts, Returns of Merchandise, Warranties, and Similar Items

The auditors should evaluate the adequacy of the entity's allowances for discounts, returns of merchandise, warranties, and similar items by: studying and evaluating the entity's processes for establishing those allowances; inquiring of management about the terms of sales and of warranties; examining evidential matter stating terms (e.g., contracts, sales catalogues, and correspondence files); reviewing historical experience; examining activity subsequent to the balance sheet date; learning of significant new products or changes in existing products during the year; learning of significant production or quality control problems during the year; and considering the results of other audit procedures (e.g., confirmations and reviews of related expense accounts).

In performing these procedures, the auditors should consider whether there are conditions suggesting that terms other than those of record or those expected in the normal course of business may have been granted. Examples of such conditions are:

- Large shipments to new customers—A company may give special terms to new customers on initial purchases;
- A change from the consignment basis of shipment to the invoiced sales basis—In conjunction with such a change, arrangements may have been made that do not alter the basic consignment nature of the transaction (e.g., the risk of loss remains with the seller, unsold goods may be returned);
- Warehousing arrangements—Goods billed to customers may be held in a warehouse for later shipment at the customers' instructions (see "Bill-and-Hold Transactions" earlier in this chapter);

- Industry practices—Special arrangements granted to certain customers regarding payment terms and rights of return are more common in some industries than in others;
- Receivables from particular customers are larger than normal, or receivables are unpaid for abnormally long periods of time;

If the auditors encounter such conditions, they should consider requesting customers to confirm the terms of sale as previously discussed.

X. Barter Transactions

The auditors should evaluate receivables arising from barter transactions to ascertain that they are bona fide receivables and that the prices used in establishing the amount are reasonable in view of the products exchanged. Such receivables will also be included in the confirmation process and will be reviewed to ascertain if the allowance for uncollectible accounts is appropriate.

XI. Unrecorded Sales and Accounts Receivable

The auditors are concerned with the understatement of receivables and revenues as well as with the overstatement of these accounts. As a consequence, they perform tests for unrecorded sales unless they have satisfied themselves that the entity has effective controls in place to achieve the control objective that all sales are recorded. If considered necessary, tests for unrecorded sales can be accomplished by tracing selected shipments from the inventory records into the sales records and customers' accounts. If the entity is engaged in the sale of services, the tracing can be made from the records of services performed. Usually, it will be necessary to test the completeness and accuracy of the inventory or service records used for this purpose. Breaks in the sequence of the sales invoice numbers in the sales register may indicate that revenues are understated. The auditors can perform tests for such breaks by accounting for selected blocks of invoice numbers.

2.2.3 Documentation

Documentation includes, but is not limited to, identification of the following:

- The procedures performed (generally the audit program or reference to it) and conclusions reached with respect to the procedures performed, together with a statement of overall conclusions with respect to receivables;
- The relationship of the nature, timing, and extent of procedures performed to the evaluation of the accounting estimation, routine data, and non-routine data processes, or reference to the documentation of such relationship elsewhere in the audit working papers (usually in the Audit Approach Plan);
- The problems encountered and bases of resolution; and
- To the extent appropriate, the following:
 - Summary of accounts receivable;
 - Aged composition of accounts receivable at the balance sheet date and, if significantly different, at the interim date as well;
 - Rationale for various dates selected for confirming or otherwise verifying accounts receivable (interim or yearend), methods used (e.g., positive and negative confirmations), and sample size (percent of total accounts and dollars). (Such rationale may be in the planning documents);

- Accounts that were selected for confirmation or other verification;
- Confirmation replies, including appropriate documentation of oral confirmations;
- Analysis of the results of the confirmation or other verification procedures (see suggested working paper format at the end of this section);
- Reconciliations between detailed listings and control accounts;
- The roll-forward of activity in the control accounts from the interim date to the balance sheet date;
- The results of investigations of unusual items appearing in control accounts or journal entries;
- The results of reviews of the receivables, sales, and inventory cut-offs;
- Summary of notes receivable and activity during the period;
- Details of any collateral and guarantees;
- Summary of interest income accrued and received on notes receivable during the period;
- Analysis of activity in the allowance for uncollectible accounts;
- Details regarding collection experience (including the period subsequent to the balance sheet date), bad debt history, and the collectability of significant individual accounts;
- Analysis of activity in the allowances for discounts, returns of merchandise, warranties and similar items, and summaries of historical experience;
- Bases for concluding whether the allowances are appropriate;
- Details of receivables from related parties;
- List of receivables transferred with recourse and details of related loss contingencies;
- Details of liens, pledges, and other security interests in receivables;
- Alternative procedures used when confirmation requests are not sent, and the rationale for not confirming accounts (the rationale would usually be in the Audit Approach Plan); and
- Results of analytical review procedures performed.

2.3 Cash & Banks

The principal objectives in auditing Cash & Bank are to determine whether:

- All cash on the balance sheet is held by the entity or by others (e.g., a bank) for the entity, (Existence financial statement assertion).
- All cash owned by the entity at the balance sheet date is included on the balance sheet, (Completeness financial statement assertion).
- Cash is stated at its realizable value, (Valuation financial statement assertion).
- The entity owns, or has a legal right to, all the cash on the balance sheet at the balance sheet date. All cash is free of restrictions on use, liens, or other security interests or, if not, such restrictions, liens, or other security interests are identified, (Rights and Obligations financial statement assertion).
- Cash is properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.3.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures (“Perform Analytical and Data Analysis Procedures”):

- Compare the listing of cash accounts with those of prior periods and investigate any unexpected changes (e.g., credit balances, unusual large balances, new accounts, closed accounts) or the absence of expected changes.
- Review interest received and/or paid in relation to the average cash balances and/or bank overdrafts.

B. Test of Details (Perform Test Of Details)

Negative results from performing such procedures could indicate matters requiring further investigation.):

- Review the cash accounts in the general ledger for unusual items.
- Review the cash disbursements and cash receipts registers for unusual items, investigate any such items observer
- Confirm compensating balance arrangements.
- Consider the implications of entity management practices that result in recurring overdrafts to finance working capital. Consider inquiry of entity management and legal counsel should such overdrafts be encountered in the audit.

C. Specific procedures (procedures that provide assurance for particular audit objectives):

- Confirm cash held by others (e.g., bank balances and/or drafts); count or confirm cash on hand, if significant.
- Examine the entity's bank reconciliations (or prepare the reconciliations). When appropriate, (e.g., to determine whether receipts or disbursements are recorded on a timely basis, or to verify the appropriateness of reconciling items) obtain cutoff bank statements.
- Test cutoff of cash receipts, cash disbursements, and transfers at the balance sheet date.

D. Other procedures responsive to the evaluation of routine data processes:

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the specific account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when the auditors have evaluated the controls as “effective” and tested them and found that they can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The auditors should consider performing these type of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is “moderate” or “high” since in such circumstances they would have assessed inherent risk as higher), and they are more likely to perform them when they have evaluated the controls as ineffective, particularly when they have assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

➤ Cash receipts application

- Perform a proof of cash by reconciling activity per entity records to activity per the bank. Also correlate to activity in Sales and Accounts Receivable. (Effectiveness of procedures is limited to less complex engagements.)
- Compare remittance advices or lists of cash receipts with the entries in the cash receipts register as to date, remitter, amount and account distribution.
- Compare the details of duplicate deposit slips with the entries in the cash receipts register. Investigate abnormal delays in depositing cash receipts.
- Compare the total amounts of daily deposits shown on the bank statements with the totals of the daily cash receipts shown in the cash receipts register. Investigate unusual delays in depositing cash receipts and any splitting of daily cash receipts into separate deposits.
- Test invoices and other original records of cash sales transactions to recorded cash sales, and recorded cash sales to supporting documents.
- Test the recording of miscellaneous receipts (i.e., receipts not usually recorded in accounts receivable, such as scrap and royalties); consider whether the recorded amounts are reasonable.
- Compare entries in the cash receipts register (e.g., date, remitter, amount and account distribution) with the remittance advices, lists of cash receipts, duplicate deposit slips and bank statements.
- Test the accounting classifications of cash receipts.
- Test the mathematical accuracy of the cash receipts register.
- Test the postings of the totals in the cash receipts register to the general ledger, customer’s ledger and other subsidiary ledgers.
- Test the authorization of credits, discounts and allowances in the cash receipts register.
- Test the posting of individual cash receipts from the cash register and supporting documents to the customers ledger.

➤ **Cash disbursements application**

- Account for the numerical sequence of checks issued during a specified period.
- Compare paid checks and supporting documents with the cash disbursements register as to date, payee, amount and account distribution; determine whether supporting documents have been marked to prevent reuse.
- Compare entries in the cash disbursements register with the paid checks and supporting documents as to date, payee, amount and account distribution; determine whether supporting documents have been marked to prevent reuse.
- Test the account classifications of cash disbursements.
- Test the mathematical accuracy of the cash disbursements register.
- Test the postings of the totals in the cash disbursements register to the general ledger and subsidiary ledgers.
- Test the posting of individual cash disbursements from the cash disbursements register to the appropriate accounts in the subsidiary ledgers.
- Determine whether the signatures on paid checks are authorized.
- Compare endorsements with the named payee and investigate double or other unexpected endorsements.

2.3.2 GUIDANCE SUPPLEMENTING ILLUSTRATIVE PROCEDURES

I. Considerations

When The auditors plan the audit of cash, they consider the differences between it and other accounts:

- Cash, due to its liquidity, is more vulnerable to misappropriation than most assets;
- Almost all the entity's transactions ultimately result in either the receipt or disbursement of cash;
- Cash balances can be determined more precisely than most other account balances and ordinarily are relatively easy to audit.

II. Reconciliation and Cut-Off Procedures

If the auditors have preliminary evaluated the controls over cash transactions as effective and have tested them to confirm their effectiveness, they may have already reviewed several of the entity's monthly bank reconciliations. As a result, they may be able to limit the year-end reconciliation and cut-off procedures to reviewing the entity's year-end reconciliations for unexpected items and to performing bank reconciliation cut-off procedures as of the balance sheet date.

Conversely, if the auditors have evaluated the controls as ineffective or if they do not intend to rely on apparently effective controls, they examine the year-end bank reconciliations in detail (or prepare them) and consider the need for examining some of the monthly reconciliations, extending the cut-off period, testing cash receipt and disbursement transactions during the year, or preparing a proof of cash for the year.

The audit of the entity's year-end bank reconciliations helps SAI obtain satisfaction regarding the cash shown on the balance sheet. The auditors should investigate unusual reconciling items, amounts reported by the bank that have not been recorded by the entity (e.g., bank debit/credit memos), deposits in transit, and checks that have been outstanding for extended periods.

The auditors should perform bank reconciliation cut-off procedures to verify the appropriateness of the reconciling items. They perform the procedures in such a way that they are able to establish that the statements and supporting documents that were given are complete and have not been altered. The auditors normally receive the cut-off statements or make arrangements with the entity that they receive the bank statements unopened.

The cut-off statements used are dated sufficiently after the reconciliation date to allow the entity's banks to clear most of the outstanding checks and other in-transit items. Factors to consider in determining the length of the cut-off period include the entity's geographic areas of operation, the payees' banking customs, and the banks' clearing procedures. Seven business days is commonly used for cut-off purposes.

In determining the extent of the cut-off procedures for cash receipts and disbursements, the auditors should consider the entity's controls for assuring that receipts and disbursements are recorded on a timely basis. The desire to show a more favorable current ratio may cause some entities to record cash disbursed in the first few days of a new accounting period as disbursements of the preceding period. Cut-off errors in recording cash receipts may be caused by poor procedures for processing cash receipts or by oversight by the individuals who process the receipts.

The tests of the cut-off of cash receipts and cash disbursements at the balance sheet date might include:

- Comparing deposits on the bank statements immediately before and after the balance sheet date with entries in the cash receipts journal to establish the reasonableness of the deposits in transit at the balance sheet date;
- Comparing the dates of the disbursement and receipt of intercompany payments or interbank transfers immediately before and after the balance sheet date to establish that both the payments and the receipts were recorded in the proper periods.

If the auditors are on the entity's premises at the end of the year, they may inspect any un-deposited cash receipts and unissued checks (or transfer requests), and note the amount of the former and the number of the first unissued check (or transfer requests).

III. Confirming Balances with Financial Institutions

The auditors should request confirmations for those deposit accounts that they consider necessary, including those that are purported to have been inactive or closed during the period.

The Standard Form to Confirm Account Balance Information with Financial Institutions is designed to substantiate the information about only the deposit and loan balances that are listed on the confirmation request; the form is not designed to seek information about other accounts that are not listed on the form. Therefore, the auditors should be aware that sole reliance on the standard form to satisfy them that all deposit and loan accounts have been identified is unwarranted. If they believe there is a significant risk that material accounts that they are not aware of may exist, they explicitly request this information from an appropriate financial institution official.

The auditors should separately confirm material accounts, agreements, or transactions other than deposit and loan balances with financial institutions by sending a separate letter signed by the entity to the financial institution official who is responsible for the institution's relationship with the entity or is knowledgeable about the account, agreement, or transaction.

Loan agreements between financial institutions and their customers may provide that the cash that is deposited in the financial institutions is pledged as security for the loans. The auditors should be alert for such arrangements because they may require disclosure in the financial statements and may conflict with the provisions of long-term loan agreements relating to the pledging of assets.

IV. Review of Cash Disbursements for Unusual Items

There is no all-inclusive list of the types of disbursements that could be considered to be unusual since the nature and circumstances of the particular entity are important determinants of whether a particular disbursement is “unusual.” However, the auditors would generally classify disbursements to the following types of payees as “unusual” and would generally perform the procedures indicated below when following up on the “unusual” disbursements that come to the auditors attention in their tests:

- Banks—Establish the nature of the expenditure being paid. Trace non-routine transfers of funds to the other bank accounts and to the record of cash received for those accounts.
- Affiliates—Obtain an understanding of non-routine transactions and establish that the cash received by the affiliate is recorded concurrently.
- Officers and employees (other than for payroll and minor expense reimbursements)—Establish the nature of the expenditure being paid.
- Cash, bearer, and other checks that were cashed instead of being deposited—Establish the nature of the expenditure being paid.

In addition to payments to the preceding payees, the auditors should be alert to any isolated payments that may be indicative of the existence of accounting problems. Examples include partial payments for major purchases of assets or payments for the acquisition of new businesses. Regularly recurring payments may indicate the need for accruals at the balance sheet date. SAI should note these payments for consideration in its search for unrecorded liabilities.

V. Cash Receipts

When cash receipts include material amounts of coins and currency, a twofold approach to testing them is often used. First, SAI should test to establish whether the money received is being reflected in cash reports, on cash slips, on register tapes, and in other basic records. These tests include tests of the numerical sequence of cash sales slips and of the controls over the “ringing up” of cash transactions on cash registers. Second, SAI should perform tests to determine whether such receipts are recorded in the cash receipts register promptly and accurately. These tests usually take the form of comparing the basic cash records and the entries in the cash receipts register.

VI. Counting Cash

If the entity has a significant amount of cash on hand, SAI may count it using the Cash Count form. Cash counts are most effective when they are performed on a surprise basis. The auditors usually count cash at the same time as they count securities and other negotiable assets. If they are unable to do so, they adopt other control procedures to prevent the substitution of one type of negotiable asset for another. The custodian of the cash should be present during the count and should sign a receipt in ink acknowledging the return of all the funds.

2.3.3 Documentation

Documentation includes, but is not limited to, identification of the following:

- The procedures performed (generally the audit program or reference to it) and conclusions reached with respect to the procedures performed, together with a statement of overall conclusions with respect to cash;
- The relationship of the nature, timing, and extent of procedures performed to the evaluation of the accounting estimation, routine data, and non-routine data processes, or reference to the documentation of such relationship elsewhere in the audit working papers (usually in the Audit Approach Plan);
- The problems encountered and bases of resolution; and
- To the extent appropriate, the following:
 - Summary of cash and bank balances;
 - Confirmation replies and details of cash counted;
 - Documentation of investigations of unusual cash disbursements, transfers between bank accounts or operating units, and deposits in transit;
 - Reconciliations between the bank statements and the entity's records;
 - Results of analytical review procedures performed;
 - Details of cut-off information (e.g., last check number used, last deposit, etc.); and
 - Details of liens, security interests, or restrictions.

2.4 Inventory Audit Program

The principal objectives in auditing inventories are to determine whether:

- All inventories included on the balance sheet are held by the entity or by others for the entity, (Existence financial statement assertion).
- All inventories owned by the entity at the balance sheet date are included on the balance sheet, (Completeness financial statement assertion).
- Inventories are carried at the lower of cost or market value. The cost and market determinations are appropriate, including adequate provisions for excess, slow-moving, obsolete, and damaged goods, and for losses on purchase and sales commitments, (Valuation financial statement assertion).
- The entity owns, or has a legal right to, all the inventories on the balance sheet. All inventories are free of liens, pledges, or other security interests or, if not, such liens, pledges, or other security interests are identified, (Rights and Obligations financial statement assertion).
- Inventories are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.4.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures (Perform Analytical and Data Analysis Procedures”):

- Compare the current period’s inventory turnover based either on cost or on units sold or produced with prior periods’ turnovers.
- Compare inventory quantities and/or costs by location, by type, and by product with prior periods’ amounts.
- Compare inventory quantities by product with units sold or used.
- Compare the current period’s gross profit ratios (by month, by location, and by product line) with those of prior periods, and/or industry averages.
- Compare the current year’s cost of sales accounts to the prior years’ and to the current year’s budget (in value or percentages), and investigate any large or unusual fluctuations or the absence of expected fluctuations.
- Compare the current year’s payroll expense accounts to the prior year’s and budgets by classification and investigate any large/unusual fluctuations or the absence of expected fluctuations.
- Compare with prior periods the relationship of payroll expense to cost of sales and sales.
- Compare budgeted usage of raw materials with the actual usage.
- Compare production reports with the recorded warehouse receipts of finished products.
- Compare the relationships of material, direct labor, and overhead costs to cost of sales with prior periods. Investigate significant unusual fluctuations or the absence of expected fluctuations.

➤ **Valuation**

- Compare the average actual unit cost charged to cost of sales during the year by product line with the costs used to price year-end inventory.
- Compare unit prices for inventory items with those of prior periods and investigate significant changes and/or unusual trends in pricing.
- Compare the relationships of actual labor and overhead costs to materials put into production with the same relationships in ending inventory. Compare with prior periods.
- Review product line operating statements and overall profitability to determine if costs are being recovered through selling prices.

➤ **Obsolete and excess inventory**

- Compare quantities estimated to be sold with forecasts of industry sales.
- Compare the quantities the entity is committed to purchase and has in hand to the quantities required for future production and/or with forecasted sales.
- Compare inventory quantities with production and storage capacities.
- Compare current year's to prior year's excess and obsolete reserve, writeoffs, and related expense as a percentage of inventory and cost of sales.
- Compare current year's to prior year's number of days cost of sales in inventory by inventory category and product line.
- Compare monthly/annual amounts sold (by product/product line) for current year and prior year.
- Compare monthly/annual amounts purchased and/or production (by product/product line) for current year and prior year.
- Compare excess and obsolete experience to patterns in entity's industry.

B. Tests of Details:

Common procedures (procedures that are considered on all audits. Negative results from performing such procedures could indicate matters requiring further investigation.):

- Determine that the costing method used is consistent with the entity's policy and with the method used in the prior year.
- Review the raw materials, work in process, and finished goods inventories accounts and the cost of sales accounts in the general ledger and subsidiary ledgers for unusual items.
- Review the nature of items included in non-inventory and cost of sales accounts in the general ledger for amounts that should be included in inventory.
- Verify the calculations of inter- and intra-company profits in inventories, and that such profits have been eliminated.
- Inquire as to the existence of damaged, slow-moving, overstock, out-of-style and obsolete inventories and of commitments for additional quantities of similar items. Make note of such items during inventory observations, review of perpetual records, price tests, and review of gross margins.
- Review and test the procedures for identifying obsolete, damaged, excess, and slow-moving inventories. Review the values assigned to such items.

- Investigate any sales and purchase commitments, back orders, or sales options to determine whether any losses are likely to be realized in the course of fulfilling the commitments. Verify the reasonableness of the allowances for such unrealized losses.
- If warehouse receipts are used as collateral for loans, confirm the details with the lenders.
- Determine the entity's procedures for investigating outside warehouses prior to entering into warehousing agreements and for maintaining controls over the inventories in warehouses after the agreements become effective.
- Review minutes, contracts and other documents for evidence of liens, pledges, or other security interests in inventories; determine that the necessary disclosures are made.
- Review the raw materials, work in process, and finished goods inventories accounts not tested in detail for unusual items.
- Review the reasonableness of the costs applied to the inventory balances not tested in detail.
- Investigate significant price variance accounts. High variances may indicate incorrect standard costs. Review for reasonableness the allocation of variances between cost of sales and year-end inventory.
- Compare costs of inventory items with current replacement costs per vendor invoices, open purchase orders, current price lists, quotes, or published market prices. Consider the effect of lower current cost on materials and purchased parts content of inventory, and on commitments for additional quantities of similar items.
- Compare costs of work in process and finished goods with selling prices as shown by recent sales invoices, current price lists (adjusted for discounts), and other sources to determine whether there is sufficient margin to cover costs to complete and dispose.

C. Physical inventory procedures

➤ Common procedures

- Review and determine the adequacy of the instructions and other written materials concerning the counting of inventories and the recording of inventory transactions near the count date.
- If the physical inventory is taken on a staggered basis throughout the period, determine the extent of the entity's counts during the period; observe one or more of the inventory counts; test the recording of the adjustments resulting from the counts to the inventory records; test count the quantities recorded in the inventory records; and test the recording of the adjustments in the general ledger accounts.
- If physical inventories are taken at an interim date or on a staggered basis during the year, review the roll-forward of activity from the date of the physical inventory to the balance sheet date and investigate unusual items; consider observing (at the balance sheet date) significant new items and those items with significant increases or decreases between the physical inventory date and the balance sheet date.
- Review for reasonableness any adjustments to the compiled inventory.

➤ **Procedures for unobserved locations**

- Obtain a copy of the physical inventory compilation and review it for reasonableness (large and/or unusual items).
- Obtain entity records of the physical count and review the results and disposition of any exceptions/problems noted.
- Review the activity in the inventory account since the physical count for reasonableness (large and/or unusual items).
- Vouch activity in the inventory account since physical count to supporting documents.
- Perform analytical review procedures such as comparing current year balance to prior year and to budget.

Specific procedures (procedures that provide assurance for particular audit objectives:

➤ **Observe the taking of physical inventories to establish that:**

- The entity's personnel are complying with the instructions for taking the inventories.
- Items belonging to the entity, or belonging to others but for which the entity is responsible, are accurately counted and recorded.
- Items to be excluded from inventory (no-value items, non-inventory items, items belonging to others) are either subject to satisfactory control and excluded from the counting process or are accurately counted and recorded, including a clear description of their non-inventory status.
- Count tags, sheets, or cards are properly controlled.
- Perform tests of the entity's counts (from the floor to recorded counts and from recorded counts to the floor); record sufficient information to be able to trace the test counts into the inventory compilation at a later date; record selected information concerning the tags, sheets, or cards that are used, partially used, unused, and voided.
- Inspect shipping, receiving, and transfer documents and the related inventory items, when appropriate, to establish the numbers of the last documents used and other information needed for subsequently verifying cutoffs in the accounting records.

➤ **Review the physical inventory compilation:**

- Trace test counts, confirmations and, if necessary, records of the count prepared by the entity (e.g., count tags, sheets or cards) to the inventory compilation. Determine that the unit of measure used in the physical inventory compilation is consistent with the unit of measure used during the physical count.
- Trace items on the final inventory listing to the physical inventory tags. Determine that the unit of measure used in the physical inventory compilation is consistent with the unit of measure used during the physical count.
- Verify that the information gathered during the physical observation regarding the tags, sheets, or cards that were used, partially used, unused and voided is accurately reflected in the inventory compilation.
- Trace the cutoff information obtained during the physical observation to the accounting records of sales and purchases.

- Test the valuation of inventory. Example procedures that may be performed are discussed under “Analytical Review Procedures,” above and “Physical inventory procedures—Other procedures responsive to possible errors in counting and costing physical inventories,” below.
- Review the reconciliation of the physical inventory compilation with the general ledger account balances and, if applicable, the perpetual inventory records; investigate large and unusual differences; determine that the general ledger accounts and the perpetual records were adjusted to reflect the physical inventory.

D. Other procedures responsive to possible errors in counting and costing physical inventories:

- Confirm inventories held by others at the physical inventory date; observe physical counts of inventories held by others if the inventories are material in amount.
- Confirm inventories held by the entity for others at the physical inventory date.
- Determine that the inventory quantities in the inventory compilation are the same as those in the physical inventory or as established by the rollforward.
- Review the inventory compilation for items with zero values or negative values and investigate them.
- Determine that the prices tested are used in the inventory compilation.
- Test the mathematical accuracy (footings and extensions) of the inventory compilation.
- Test the mathematical accuracy of the compilation of unit costs of items in work-in-process and finished goods.
- Test raw material unit costs by reference to vendor invoices.
- Vouch the costs and agree the quantities of materials in work-in-process and finished goods inventory that have been costed at actual costs to supporting documentation.
- Vouch the hours and rates for labor in work-in-process and finished goods inventory that have been costed at actual costs.
- Review the expense accounts included in or excluded from overhead to determine whether their inclusion or exclusion is appropriate and consistent.
- Review the activity in the accounts included in overhead and vouch any large/unusual items.
- Review the activity in the accounts excluded from overhead to determine whether any items should have been included in overhead.
- Verify the accuracy of the denominator (e.g., direct labor dollars or hours) used in calculating the overhead rate.
- Test the calculation of the overhead rate.
- Test the application of overhead to work-in-process and finished goods inventory.
- Test the buildup of overhead costs in work in process inventory and review the stage of production for reasonableness.

- Review the materials purchase price variance account taking into consideration whether:
 - There were changes to standards during the year that might affect the allocation of the variance between inventory and cost of sales at year-end;
 - The variance is representative of the year-end mix of inventory;
 - The data in the variance account or the application that generates the data in the variance account has been tested.
- Test the unit costs of materials in work-in-process and finished goods inventories by reference to recent invoices.
- Review the reasonableness of the required materials shown on engineering reports and bills of materials.
- Test the reasonableness of materials included in the development of standard costs or as shown on engineering reports and bills of materials by comparing them to the materials actually used in finished products.
- Review the materials usage variance account taking into consideration whether:
 - There were changes to standards during the year that might affect the allocation of the variance between inventory and cost of sales at year-end;
 - The variance is representative of the year-end mix of inventory;
 - The data in the variance account or the application that generates the data in the variance account has been tested.
- Test the labor rates used to audited payroll records, union agreements, etc.
- Review the reasonableness of the labor hours on engineering reports and bills of materials.
- Test the reasonableness of the labor hours included in the development of standard costs or as shown on engineering reports and bills of materials by comparing them to the actual labor hours in finished products.
- Review the labor variance accounts taking into consideration whether:
 - There were changes to standards during the year that might affect the allocation of the variance between inventory and cost of sales at year end;
 - The variance is representative of the year-end mix of inventory;
 - The data in the variance account or the application that generates the data in the variance account has been tested.
- Test the buildup of the costs of materials in work-in-process inventory and review the determination of the stage of production for reasonableness.
- Determine whether the labor hours in work in process are reasonable when compared with those tested when auditing finished goods.
- Test the buildup of labor costs in work-in-process inventory and the relationship of the costs to the stage of production for reasonableness.

E. Other procedures responsive to the evaluation of routine data processes

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the auditors evaluation of routine data processes indicates possible errors. These procedures are not performed when they have evaluated the controls as “effective” and tested them and found that they can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The auditors should consider performing these types of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is “moderate” or “high” since in such circumstances SAI would have assessed inherent risk as higher), and are more likely to perform them when SAI have evaluated the controls as ineffective, particularly when it has assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

In determining whether applications are significant in auditing inventory and cost of sales, the auditors should consider:

- How the applications affect the entity’s process for establishing the inventory balance (i.e., whether they process information that could contain errors of audit importance) and;
- Whether they produce information that is important in auditing the data or judgments in inventory.

For example, an application may be significant for the following reasons:

- The entity relies on the application to establish the quantities or the valuation of the inventory;
- The application serves as the basis for rolling forward the inventory balances;
- The application produces records or information used in establishing the balances (e.g., purchasing records are used to determine unit costs of materials or payroll records are used to establish labor rates).

Previously selected tests of transactions (“TOTs”) that relate to the Purchasing or Payroll application may not provide adequate assurance for Inventory accounts. This is because the population from which transactions are selected must be considered when determining whether TOTs provide assurance for other accounts. For example, if a sample is selected from all purchases during the year, it probably will not provide much assurance for Inventory unless the preponderance of purchase transactions relate to Inventory. Therefore, the auditors should separately evaluate the extent of TOTs procedures required when planning Inventory. The timing and extent of procedures performed are responsive to the risk assessment.

➤ **Purchases application**

- Test the records of goods and services ordered by comparing purchase requisitions and purchase orders to vendors' invoices.
- Test the record of goods and services received by comparing receiving documents to vendors' invoices.
- Test vendors' invoices to the voucher register (or other initial record of entry).
- Test the records of goods and services purchased to the records of goods and services ordered and received by comparing the voucher register to vendors' invoices.
- Test the records of goods and services purchased to the records of goods and services ordered and received by comparing vendors' invoices to purchase orders and requisitions, receiving documents, or evidence of receipt of services.
- Consider the reasonableness of the quantities and the business purposes of the items purchased.
- Compare the prices on purchase orders and vendors' invoices with those in vendors' catalogs.
- Test the mathematical accuracy of invoices.
- Test the timely recording of purchases to the voucher register.
- Establish the account distributions in the voucher register by comparing the nature of the goods or services purchased with the descriptions of the accounts.
- Test the posting of individual purchases in the voucher register to the vendors' ledger accounts as to the proper vendor, invoice number, date, and amount.
- Test the mathematical accuracy of the voucher register.
- Test the postings of the totals in the voucher register to the general ledger and subsidiary ledgers.

➤ **Payroll application**

- Account for the numerical sequence of paid payroll checks during a specified time period.
- Compare the payrolls at the beginning and end of the period to identify changes in employees and pay rates.
- Compare hours paid with the record of hours worked (e.g., time cards).
- Trace the payroll checks to the payroll register.
- Agree the record of labor performed (time cards or job tickets) to the labor cost distribution.
- Obtain a list of employees who left during the period from a source other than the payroll department (e.g., the personnel department), and determine that the former employees were removed from the payroll on a timely basis.
- Observe, on a surprise basis, the distribution of payroll checks to employees.
- Investigate the handling of unclaimed payroll checks.
- Compare employee data (e.g., name, identification number, department, employee status or group, location, wage rate, deductions) to authorizations on file (e.g., hiring records, personnel files for wage rates and deductions, union contracts).

- Compare names, net pay and other data in the payroll register to the canceled payroll checks. Examine endorsement(s) on payroll checks and compare them to specimen signatures in the personnel files; investigate unusual or multiple endorsements.
- Test the extensions of the wage rates times the hours worked.
- Test the timely recording of payroll cost to payroll records.
- Review the appropriateness of the labor cost distributions based on the nature of work performed (e.g., examine time cards or job tickets).
- Test the mathematical accuracy of payroll register and the labor cost distribution.
- Test the postings of totals in the payroll register and the labor cost distribution to the general ledger and the subsidiary ledgers.
- Compare the labor cost distribution totals to the payroll register.
- Test the mathematical accuracy of the individual labor cost distributions.

➤ **Inventory/cost of sales application**

- Test the posting of purchases, production, transfers, and shipments of inventories to the perpetual (or other) inventory records.
- Test the recording of acquisitions, transfers, and dispositions of inventories to the general ledger accounts.
- Test transactions recorded in the perpetual (or other) inventory records to the supporting documentation.
- Test transactions recorded in the general ledger inventory accounts to supporting documentation.
- Test the costing of inventories produced and sold by reference to cost data.
- Test the timely recording of purchases, shipments, etc. to the inventory records.
- Test the mathematical accuracy of the inventory and related journals (e.g., cost of sales journal, production journal, labor distribution reports, etc.).

2.4.2 GUIDANCE SUPPLEMENTING ILLUSTRATIVE PROCEDURES

I. Considerations

The significance of inventories to the financial statements and the significance of the accounting, auditing, and reporting problems that may arise in this area frequently cause SAI to devote a considerable proportion of the total audit time to the inventory and related accounts. In planning the audit, SAI should recognize that specialized accounting, auditing, and reporting considerations may apply to certain inventories (e.g., oil and gas, precious metals, and chemicals).

The nature, timing, and extent of the substantive audit procedures for inventories depends, to a great extent, on the sophistication of the entity's inventory and cost of sales application, the effectiveness of controls over the application, and the reasonableness of the applicable accounting estimation and non-routine data processes (e.g., the processes for determining any write-downs to market and for compiling the physical inventory, respectively). Other significant factors affecting the nature, timing, and extent of the inventory procedures include:

- The accounting methods used (e.g., actual or standard costs; first-in, first-out (FIFO); last-in, first-out (LIFO); or average costs);
- The locations, types, and condition of the inventory;
- The entity's physical inventory procedures; and
- Economic conditions, especially those that affect the entity's ability to sell the inventory at a profit.

Because the audit approaches for inventories vary substantially, depending on the particular circumstances of the individual engagement, the guidance set out below is necessarily general.

II. Physical Inventories

The International Standard on Auditing pertaining to audit evidence requires physical inventory observations to be performed by SAI whenever it is practicable and reasonable to do so when inventory is material to the financial statements. If SAI judges that the taking of the physical inventories cannot be observed, it should prepare a memorandum substantiating the impracticability and unreasonableness of observing them and select alternative procedures for supporting (or refuting) the existence and completeness assertions (which might include test counting the inventory after the count date).

The auditor should bear in mind that tests of accounting records alone are not sufficient evidence of inventory quantities. Some physical counts will always be necessary.

SAI approach to auditing inventories is influenced significantly by the entity's process for determining the inventory quantities. For example, whether the entity:

- Takes a complete physical inventory at the balance sheet date;
- Takes a complete physical inventory at an interim date that is reasonably close to the balance sheet date; or
- Makes cycle counts (i.e., whether it counts different items at different times during the year and compares the quantities to the perpetual records).

If the entity's primary method of determining the inventory quantities is to take a complete physical inventory at or near the balance sheet date, SAI should ordinarily place more emphasis on auditing the priced-out compilation of the physical inventory rather than on the inventory and cost of sales application. Conversely, if the entity relies principally on its inventory and cost of sales application for determining the inventory quantities and/or the inventory and cost of sales amounts, the auditors should place more emphasis on testing the effectiveness of controls over the application. Thus, the effectiveness of controls is of greater importance to SAI when an entity takes a complete physical inventory at an interim date or when it relies on cycle counts and the perpetual records than when the entity takes a complete year-end physical inventory.

When a complete physical inventory is taken at an interim date or when the entity relies on cycle counts and the perpetual records, there is the potential that errors of audit importance in the inventory quantities will arise during the period from the count date to the balance sheet date. In such a case, the effectiveness of controls over the inventory and cost of sales, sales and accounts receivable, and purchases and accounts payable application will significantly affect the entity's ability to produce an accurate inventory at the balance sheet date. Because, even with effective controls, the chances for error increase as the period between the count date and the balance sheet date increases, entities are encouraged to count their inventories reasonably near year end.

When an entity relies heavily on the perpetual records to determine the inventory quantities and checks the accuracy of the records by partial counts on a continuous or cycle basis, the auditors should observe the counting process to the extent necessary to confirm the preliminary evaluation of the effectiveness of the count procedures. When the auditors plan the approach to the audit of physical quantities in these circumstances, they should recognize that it will differ from the approach when all the inventory is counted at once.

For example, SAI will evaluate the entity's controls for ensuring that all of the adjustments to the perpetual records to reflect the physical counts are properly valued and recorded in both the perpetual records and the general ledger, and that the adjustments reflect an appropriate cut-off of purchase, production, and sales transactions. SAI should also recognize that the existence of numerous book-to-physical adjustments may indicate that the controls over the inventory and cost of sales application are not effective enough to rely on.

If inventories are taken at an interim date, SAI should review the roll-forward of the inventory and cost of sales accounts to satisfy itself that the activity in these accounts from the date of the physical inventory to the date of the balance sheet is reasonable. Effective controls that are tested may allow SAI to confine the roll-forward procedures to a review of the entries in the general ledger, a comparison of the gross profit margins during the intervening period with those in prior months, and a year-end cut-off.

If there are effective controls that are not tested, SAI needs to test the support for the entries. However, if the entity has ineffective controls over the inventory and cost of sales accounts, the physical inventory will have to be performed at year end or SAI will need to perform extensive tests of the support for the entries.

III. Physical Inventory Observation

Counting the inventory items is primarily the entity's task and not ours. Therefore, SAI should observe that the instructions (typically reviewed by the auditors in advance of the observation) for taking the physical inventories are being followed by the entity's count teams and that the inventory that is purported to be on site is, in fact, on site. The Inventory Observation Checklist Form highlights the audit procedures and considerations usually employed during the physical inventory observation. SAI should make as many test counts of the inventory items as it needs to be satisfied with the diligence and accuracy of the count teams, and to test the entity's compilation of the physical counts. The Inventory Test Counts form helps SAI accumulate the necessary information for test counts recorded during the inventory observation. When completed, it becomes part of the audit working papers and documents the tie-in of inventory quantities observed to the entity's final inventory listing.

The extent of the observations and tests of the taking of the physical inventories depends on many factors, including the adequacy of the inventory instructions; the skills, attitudes and independence of the employees assigned to count the inventories; the entity's supervision of the counting process; the materiality of the inventories; and the problems anticipated. SAI should concentrate its efforts on the locations or categories that represent the bulk of the values and on the individual items that are of the greatest value. At the same time, SAI should make limited tests in other areas and of other items so that the tests will provide representative information about the inventories. Particular attention is given to areas in which counting is unpleasant or difficult. To achieve good coverage of the inventories, the auditors should consider selecting the items to test count from each of three sources: (1) the perpetual inventory records; (2) the count-tags, sheets, or cards; and (3) the inventory itself.

The auditors are aided in observing the taking of the physical inventories if they have a relatively good knowledge of the individual items in the inventories. They attempt to know what items should be in inventory, what items are components of other items, and what items are to be excluded from inventories. Inspection of bills of materials, the perpetual inventory records, and engineering and production documents prior to starting the observation, and during the observation as is necessary, help the auditors to acquire the desired information.

When the entity uses statistical sampling to estimate the inventory quantities, the auditors satisfy themselves that the sampling plan is reasonable and statistically valid, that it has been applied properly, and that the results are reasonable in the circumstances. They may wish to consult a person with expertise in sampling for assistance in gaining the necessary satisfaction.

In audits of larger entities, internal auditors often participate with SAI in observing and testing the taking of the physical inventories. Generally, this co-operative approach is taken for two purposes: (1) to maximize the verification of the inventory counting, and (2) to reduce the required effort. SAI should be aware that it cannot regard the work of the internal auditors as its own. However, by using the work of the internal auditors, SAI may be able to reduce its efforts to minimum tests of the inventories.

Some entities use outside firms that specialize in taking physical inventories. In such cases, the auditors still observe and test the taking of the physical inventory. They may reduce (but not eliminate) the extent of the tests when they are satisfied with the competence and independence of the outside firm.

The auditors should confirm inventories held by others and inventories held by the entity for others at the physical inventory date, and they should observe the physical counts of inventories held by others if the inventories are material in amount.

IV. Compilation and Costing

The audit of the inventory compilation ordinarily includes:

- Tracing the physical counts into the compilation (which may be a priced listing of all the items in the inventory or may be represented by the perpetual records after they have been adjusted for any differences from the physical counts);
- Verifying the prices of selected items; and
- Verifying selected extensions and footings.

The tracing of the physical counts into the inventory compilation can, in many cases, be confined to tracing in the test counts, if the auditors are satisfied with the effectiveness of the entity's non-routine data process for compiling the inventory and if they do not encounter errors when tracing in the test counts. If they believe that more physical counts need to be traced into the compilation, the auditors should trace in a sample of the entity's count records. They should also perform the opposite procedure of tracing items in the compilation to the supporting count records.

The auditors should compare with the inventory compilation the information obtained during the physical observation regarding the tags, sheets, or cards that were used, partially used, unused, and voided. They do this to determine whether the tags, etc., that were used were included in the compilation and to determine that the unused tags, etc., were not subsequently filled out and included in the compilation.

The entity's method of costing its inventories and the nature of its inventories (raw materials, purchased parts, work-in-process, finished goods, etc.) strongly influence the procedures for examining the recorded cost of the inventory.

In auditing an inventory priced at standard costs, the auditors should test the standard costs to determine whether they reasonably approximate actual costs under one of the recognized bases of determining costs (such as FIFO (first-in, first-out) or average cost). Two techniques for auditing standard costs are:

- Examining the make-up of the detailed standard costs for a sample of inventory items; and
- Determining the extent to which the overall standard costs approximated the actual total costs during the period.

The second technique may be accomplished by reviewing the variance accounts to determine their amounts and causes, and by determining whether the variances that relate to inventory at the balance sheet date have been reflected in the year-end inventory balances, if appropriate. Combination of both techniques can be used.

The procedures for testing the direct labor and overhead costs included in work-in-process and finished goods inventories and in cost of sales depend in part on the nature of the production process, on the nature of the accounting applications that record the costs, and on the effectiveness of the controls over the applications. Direct labor costs may be verified by testing the detailed records that support the labor costs for individual inventory items.

The extent of these tests depends on the degree of reliance the auditors place on the controls over the payroll application, especially on the controls over the labor distribution (i.e., the “classified” objective). The auditors may verify the overhead cost pools by testing the costs included in them. In performing these tests, they consider the appropriateness of the types of costs included in overhead (selling and administrative costs are not normally included) and the consistency with which the costs are allocated among the overhead pools.

The application of overhead to inventory is normally accomplished by relating total overhead costs (including indirect labor costs) to some measure of production or production costs (such as direct labor costs). The auditors should review the propriety and consistency of the method of applying the overhead costs, and the accuracy of the calculations and the data used in applying the overhead.

V. Valuation

SAI should also determine that the inventory is carried at the lower of cost or market, and that adequate consideration has been given to identifying and valuing obsolete, damaged, slow-moving, excess, and other inventory items whose cost may not be fully recoverable.

The term “market” refers to replacement cost (by purchase or reproduction) or net realizable value (estimated selling price less reasonably predictable costs of completion and disposal) or, on occasion, net realizable value reduced by a normal profit margin. The replacement cost of purchased materials generally can be verified by referring to purchase orders, vendors’ catalogues, or market quotations.

In examining the net realizable values of finished goods and work-in-process, the auditors generally use (1) selling prices evidenced by sales subsequent to the balance sheet date, by the entity’s catalogues or price lists, or by customers’ contracts; and (2) calculations of the costs to complete or dispose of the items.

When using the lower of cost or market rule, the auditors should consider whether it is appropriately and consistently applied to individual inventory items, to categories of related items, or in certain circumstances, to the inventory as a whole.

Determining the propriety of the entity’s valuation of the inventory includes procedures to test the salability of the inventory and to test for unrealized losses on sales and purchase commitments. Potential obsolescence losses may be discovered when examining the physical inventory (e.g., the presence of dusty and “buried” items), when reviewing the detailed perpetual inventory records for usage, and when comparing the inventory compilation with those of prior years. The examination of sales backlogs, sales catalogues, sales commitments, and sales contracts may also disclose changes in the entity’s business that in turn may indicate that certain merchandise can be sold only at “distress” prices.

SAI should review the allowances for reducing the inventory from cost to market by evaluating the ultimate recoverability of the cost of the inventory items in question. Among the factors SAI should consider are:

- Their scrap or salvage value;
- Possible alternative uses for them (e.g., raw materials or components may be used in manufacturing items other than the items in which they are normally used);

- Their realizable value if they are sold by methods or in markets other than the usual ones (e.g., through jobbers, or for export rather than directly to domestic retailers);
- Expected changes in customers' preferences that may or may not result in the items being or becoming obsolete;
- The possibilities of selling the items by reducing their prices;
- The possibilities that raw materials may be returned to vendors for credit; and
- Projected or budgeted sales of apparently excess quantities.

VI. Cost of Sales

Two approaches available to help SAI achieve satisfaction with the costing of products sold are:

- Using analytical review procedures (ARPs) to examine and analyze the overall relationships between sales and cost of sales; and
- Testing the costing of a sample of sales transactions.

The first approach is used on most engagements; the second is used primarily when the entity has a job order cost system and SAI is not relying on the entity's controls, if any, to ensure that individual jobs are costed correctly. In some businesses, considerable time elapses between the completion of the first and the final items of a customer's order. In such cases, partial shipments of the items completed to date are frequently made. Determining the costs of the items shipped may be difficult because the entity may have to estimate the costs yet to be incurred and the number of items to be produced in order to determine the costs of the units already shipped. In evaluating and testing a entity's methods for costing partial shipments, the auditors should obtain information to enable them to test and evaluate the market value of the unbilled items in the jobs examined. For those items, they should satisfy themselves that the final costs of the unbilled items will not exceed their sales prices less the costs of their disposal. They should further satisfy themselves that the entity has established satisfactory procedures for evaluating the market value of all incomplete production.

2.4.3 Documentation

Documentation includes, but is not limited to, identification of the following:

- The procedures performed (generally the audit program or reference to it) and conclusions reached with respect to the procedures performed, together with a statement of overall conclusions with respect to inventories;
- The relationship of the nature, timing, and extent of procedures performed to the evaluation of accounting estimation, routine data, and non-routine data processes, or reference to the documentation of such relationship elsewhere in the audit working papers (usually in the Audit Approach Plan);
- The problems encountered and bases of resolution; and
- To the extent appropriate, the following:
 - A statement of the nature of the inventories and the costing methods used;
 - Information regarding the observation and confirmation of physical inventories (e.g., locations; test counts; cut-off data; the tags, sheets, or cards used; dollar value of the inventory observed; and confirmation replies);
 - Explanations of major adjustments to recorded inventories resulting from physical inventories or other causes;

- Identification of valuation considerations, such as loss contracts, net realizable value; replacement cost, obsolescence, slow-moving, and excess quantities, and defective merchandise;
- Analyses of the changes in the composition, amount, quality, etc. of the inventory and in the gross profit and turnover ratios since the preceding year, and the reasons for such changes;
- Results of other analytical review procedures performed;
- Analyses of commitments to purchase, manufacture, or sell inventories that will result in losses to the entity;
- A description of the entity's plans that could affect the valuation of existing inventories, and its plans for developing the company's products;
- A list of the liens against, pledges of, and other security interests in inventories; and
- The procedures followed to disclose cut-off errors if physical inventories were taken at one date and receivables were confirmed at another date.

2.5 Property Plant and Equipment Audit Program

The principal objectives in auditing property, plant, and equipment are to determine whether:

- All property, plant, and equipment on the balance sheet (including assets leased under capital leases) are held by the entity or by others for the entity, (Existence financial statement assertion).
- All property, plant, and equipment owned or leased under capital leases by the entity at the balance sheet date are included on the balance sheet, (Completeness financial statement assertion).
- Property, plant, and equipment are carried at the appropriate amount (taking into account accumulated depreciation, depletion, or amortization). The cost of the plant and equipment is allocated to the appropriate accounting periods in a systematic and rational manner. The undepreciated cost of the property, plant, and equipment used in the business is expected to be recoverable through future use. Property, plant, and equipment held for disposal are carried at the lower of cost (less accumulated depreciation) or net realizable value, (Valuation financial statement assertion).
- The entity owns, or has a legal right to, all the property, plant, and equipment on the balance sheet at the balance sheet date. All property, plant, and equipment are free of liens, pledges, security interests, and restrictions or, if not, such liens, pledges, security interests, and restrictions are identified, (Rights and Obligations financial statement assertion).
- Property, plant, and equipment, and related accounts are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.5.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures ("Perform Analytical and Data Analysis Procedures):

- Review a summary of property, plant, and equipment by classification and location that indicates acquisitions and sales or retirements during the period; compare with prior periods, authorized expenditures and other plans (e.g., budgets); investigate any unexpected changes (or the absence of expected changes).
- Compare relationships of provision for depreciation and related allowance account to asset balance. Review reasonableness of change and allowance since prior year end.
- Review reasonableness of provision of depreciation by reference to prior year provision and the effects of acquisitions and disposals.

B. Tests of Details:

Negative results from performing such procedures could indicate matters requiring further investigation.

- Test calculations of capitalized interest to determine if the appropriate rates, amounts and capitalization periods have been used.
- Determine the tax basis of accounting for property, plant, and equipment transactions and verify that any book-tax differences have been accounted for properly.
- Examine lease agreements to determine whether leases are appropriately classified as capital or operating; determine whether the proper accounting has been performed; and determine whether appropriate disclosures are made.
- Review the property, plant, and equipment and related accounts in the general ledger for unusual items.
- Ascertain the business reasons for unusual additions and disposals.
- Inspect evidence of ownership (e.g., deeds, tax bills, and title policies for real property and registration certificates for vehicles) or rights to use the property, plant, and equipment (i.e., capital leases). Obtain direct confirmation of ownership if the deeds are held by a custodian.
- Review minutes, agreements, legal filings, and other documents (e.g., bank and loan confirmations) for evidence of liens, pledges, security interests and restrictions on property, plant, and equipment.
- Review minutes, agreements, capital budgets and subsequent appropriations for evidence of plans or commitments for future additions (including rentals under capital leases), sales, retirements, and abandonments.
- Review the cash receipts journal for sales of property, plant, and equipment.
- Inquire as to the existence of, and review detailed records for, major items of property, plant, and equipment that are not in service. Consider the likelihood that property, plant, and equipment will become idle in the foreseeable future (due to a significant drop in production or a change in product lines).
- Determine that property, plant, and equipment that is being held for sale or that is no longer being used is carried at the appropriate amount.
- If evidence indicates that the undepreciated cost of major facilities in service (i.e., being used and not held for sale) is not expected to be recovered, determine that such items have been written down to an appropriate amount.

➤ **Specific procedures:**

- Examine invoices, capital expenditure authorizations, leases, and other data (e.g., in-house construction work orders) supporting additions and disposals to property, plant, and equipment during the period.
- Review and, when appropriate, examine support for rentals under operating leases and for significant charges to repairs, maintenance, and other expense accounts to determine if they should be capitalized as property, plant, and equipment.
- Test computations of depreciation, depletion and amortization to determine if acceptable methods and appropriate lives (or other bases for allocating costs) are being used, and if they are consistent with the methods and lives used in prior periods.

C. Other procedures responsive to the evaluation of routine data processes:

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when the auditors have evaluated the controls as “effective” and tested them and found that they can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The auditors should consider performing these types of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is “moderate” or “high” since in such circumstances they would have assessed inherent risk as higher), and are more likely to perform them when they have evaluated the controls as ineffective, particularly when they have assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

➤ Cash receipts, cash disbursements, and purchasing applications

- Test the cutoff of the additions to property, plant, and equipment including, when applicable, transfers from construction in progress.
- Inspect authorizations and other data supporting retirements, sales, and other disposals and test the computations of the resulting gains and losses. Determine that any such assets and the related accumulated depreciation have been removed from the accounts.
- Review the cash receipts journal for sales of property, plant, and equipment.
- Compare vendors’ invoices to the initial record of entry (voucher register).
- Compare repairs and maintenance expense for the period with that of prior periods and budgets, and investigate any unexpected changes (or the absence of expected changes).
- Compare the actual costs of additions with the authorized or estimated amounts; investigate the reasons for any significant differences.
- Examine support for rentals under operating leases and for significant charges to repairs, maintenance, and other expense accounts to determine if they should be capitalized as property, plant, and equipment.
- Inspect selected assets and trace them to the detailed property, plant, and equipment records to determine that they are recorded.
- Verify the physical existence of recorded fixed assets by selecting items from the schedule of additions for the year or from the detailed property, plant, and equipment records and by inspecting the assets.
- Compare the voucher register to vendors’ invoices.
- Compare vendors’ invoices to purchase orders and purchase requisitions, receiving documents, or evidence of receipt of services.
- Consider the reasonableness of the quantities and the business purposes of the items purchased.
- Compare the prices on purchase orders and vendors’ invoices with those in vendors’ catalogs.
- Test the mathematical accuracy of invoices.

- Agree the detailed records of property, plant, and equipment and of the related depreciation, depletion and amortization with the appropriate general ledger accounts.
- Test the account distributions in the voucher register by comparing the nature of the goods or services purchased with the descriptions of the accounts.
- Test the mathematical accuracy of the property, plant, and equipment register.
- Test postings of additions and disposals to the voucher register.
- Test the mathematical accuracy of the voucher register.
- Test the posting of individual purchases in the voucher register to the vendors' ledger accounts as to the proper vendor, invoice number, date and amount.
- Is depreciation correctly calculated in accordance with the organization's accounting policies?

2.5.2 GUIDANCESUPPLEMENTING ILLUSTRATIVE PROCEDURES

I. Considerations

In planning the audit of property, plant, and equipment, the auditors should be aware that although these assets are often material items in an entity's balance sheet, the account balances often do not change significantly from year to year, or changes (such as depreciation or programs for major capital additions) are predictable or are evidenced by substantial documentation in the entity's records. Accordingly, the substantive tests normally emphasize the review of significant additions and disposals, and analytical procedures to test the provisions for depreciation, depletion, and amortization.

II. Carrying Basis

The auditors should determine whether property, plant, and equipment have been properly recorded, usually at purchase or acquisition cost. An enterprise that constructs assets for its own use may capitalize the interest cost that it incurs, as a result of expenditures for the asset, during the period of time required to bring the asset to the condition and location necessary for its intended use (IAS No. 16, "Property, Plant and Equipment"). In some instances (e.g., if property is donated or acquired for consideration other than cash), fair market values, usually determined by appraisals, may be used. Also, IAS No. 20, "Accounting for Government Grants and Disclosure of Government Assistance," provides guidance for government grants related to construction or otherwise acquired long-term assets. In such cases, the auditors should evaluate whether the accounting is appropriate by reviewing the supporting documentation and by comparing the fair market values to the costs of similar items.

The auditors should determine whether fixed assets that are no longer being used or that are being held for sale (including those that are part of a "discontinued operation") are carried at the lower of undepreciated cost or net realizable value appropriate amount. The existence of such property may come to the auditors' attention through, among other things, analyses of changes taking place in the entity's business, plant tours, reviews of employment data, and management representations.

On occasion, the auditors may encounter situations where evidence indicates that the undepreciated cost of major operating assets not intended for disposal may exceed the amount expected to be recoverable through future use of the assets. In those uncommon situations, they should consider whether a permanent impairment exists that requires a write-down of the fixed assets to net realizable value.

SAI should determine the entity's accounting policy for fully depreciated assets (preferably, the costs of such assets and the related depreciation are retained in the accounts until the assets are no longer in use) and determine that the policy has been consistently followed (see following discussion of estimated useful lives).

III. Depreciation, Depletion, and Amortization

SAI will often use analytical procedures to obtain satisfaction regarding the reasonableness of the recorded depreciation and amortization. For example, SAI may be able to compare the depreciation expense or the effective depreciation rates by classification and location of property, plant, and equipment with similar data for the previous year. If SAI can use analytical procedures effectively, SAI may be able to reduce or eliminate the detailed tests of depreciation of individual items.

SAI should ordinarily review the reasonableness of estimated useful lives in the period in which major additions are placed in service and determine that such lives are used consistently thereafter. SAI should be alert, however, for situations which may arise where evidence indicates that useful lives should be revised to prevent significant over- or under-provisions of depreciation. Large amounts of fully depreciated assets in use or large amounts of assets being disposed of well in advance of the end of their assigned useful lives, possibly as a result of changing technology or market conditions, may indicate a need to revise their estimated useful lives.

When the entity's assets include natural resources, SAI should review the geologic surveys, the results of the entity's explorations, and other information used by the entity in estimating its recoverable quantities. SAI should also consider using independent experts in this area.

If different methods of depreciation are used for financial reporting and income tax purposes, the auditors should determine whether depreciation and gains and losses on disposals have been computed properly for income tax purposes. They should also verify that any resulting deferred income taxes have been properly computed.

IV. Leases

SAI should examine significant lease agreements to determine whether leases are appropriately classified as capital or operating; determine that the proper accounting has been performed; and determine whether appropriate disclosures are made (IAS No. 17, "Accounting for Leases").

V. Physical Observation

The auditors should consider the need to physically inspect important assets and significant additions if controls over property, plant, and equipment are ineffective or if they have reason to doubt the existence of assets reflected in the property accounts. They should give attention to significant amounts of capital assets that are readily portable, such as cars, trucks, and other vehicles. In addition, a tour of the plant provides an opportunity to observe the existence and condition of the assets.

Some entities who maintain detailed records of property, plant, and equipment take periodic physical inventories of the assets for comparison with such records. If this is done, the auditors should consider the benefits to be derived from observing the physical inventories or reviewing the results.

2.5.3 Documentation

Documentation includes, but is not limited to, identification of the following:

- The procedures performed (generally the audit program or reference to it) and conclusions reached with respect to the procedures performed, together with a statement of overall conclusions with respect to property, plant, and equipment;
- The relationship of the nature, timing, and extent of procedures performed to the evaluation of the accounting estimation, routine data, and non-routine data processes, or reference to the documentation of such relationship elsewhere in the audit working papers (usually in the planning documents);
- The problems encountered and bases of resolution; and
- To the extent appropriate, the following:
 - Summary of property, plant, and equipment, and related accounts and activity in those accounts during the period;
 - Details of and business reasons for significant additions and disposals;
 - Statements of the entity's policies for capitalizing and depreciating property, plant, and equipment, including an indication of whether the policies have been consistently applied;
 - Details of the computation of the capitalization of interest;
 - Conclusions regarding the appropriateness of the net carrying values of property, plant, and equipment that is no longer used or that is held for sale;
 - Comparative summary of depreciation expense and depreciation rates for the current and previous years and/or of the analytical review procedures used to test the reasonableness of depreciation expense for the year;
 - Details of liens, pledges, security interests, or restrictions on the ownership or disposal of property, plant, and equipment;
 - Plans or commitments for important future additions (including rentals under capital leases), sales, retirements, and abandonments.

2.6 Account Payable

The principal objectives in auditing accounts payable are to determine whether:

- All accounts payable on the balance sheet are real debts due to suppliers or other creditors of the entity for goods received or services performed, (Existence financial statement assertion).
- All accounts payable owed by the entity at the balance sheet date are included on the balance sheet, (Completeness financial statement assertion).
- Accounts payable are stated at the amounts owed at the balance sheet date, (Valuation financial statement assertion).
- The accounts payable on the balance sheet represent obligations of the entity at the balance sheet date. The accounts payable are not secured by liens on assets, security interests, or other collateral unless otherwise indicated, (Rights and Obligations financial statement assertion).
- Accounts payable are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.6.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures

- Compare the list of accounts payable with those of prior periods and investigate any unexpected changes (e.g., changes in major vendors, in the proportion of debit balances, in the aging of the accounts) or the absence of expected changes.
- Compare the number of days' purchases in accounts payable with prior years.

B. Tests of Details ("Perform Tests of Details"):

- **Common procedures (procedures that are considered for all audits. Negative results from performing such procedures could indicate matters requiring further investigation):**
 - Test the account distributions in the voucher register by comparing the nature of the goods or services purchased with the descriptions of the accounts.
 - Trace the total of the detailed listing of accounts payable to the total accounts payable in the general ledger.
 - Identify security interests and assets pledged as collateral for accounts payable by confirmation with creditors and/or by inspecting public records, and by reviewing minutes and other documents.
 - Review debit memos and other similar adjustments after year end.

➤ **Specific procedures:**

- Examine the entities' bank reconciliations (or prepare the reconciliations). When appropriate, e.g., to determine whether receipts or disbursements are recorded on a timely basis, or to verify the appropriateness of reconciling items, perform bank reconciliation cutoff procedures.
- Test the cutoff by inspecting the voucher register, receiving records, vendors' invoices and other supporting documents immediately before and after the cutoff date and determine that the transactions were recorded in the proper period; compare payables cutoff to cutoff in related areas (e.g., inventories).
- Perform a search for unrecorded liabilities at the inventory date and/or year end by selecting subsequent disbursements and unmatched invoices and receiving reports to examine.

C. Other procedures responsive to the evaluation of routine data processes:

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when SAI have evaluated the controls as "effective" and tested them and found that it can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The auditors should consider performing these types of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is "moderate" or "high" since in such circumstances they would have assessed inherent risk as higher), and are more likely to perform them when they have evaluated the controls as ineffective, particularly when they have assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

➤ **Cash disbursements application**

- Test cutoff of cash disbursements and transfers at the balance sheet date.
- Account for the numerical sequence of checks issued during a specified period.
- Compare paid checks and supporting documents with the cash disbursements register as to date, payee, amount and account distribution; determine whether supporting documents have been marked to prevent reuse.
- Confirm accounts payable.
- Obtain the listing of accounts payable and trace the details to the voucher register, vendors' ledger, vendors' statements, or other record of detailed accounts; investigate debit balances, and other unusual items.
- Compare entries in the cash disbursements register with the paid checks and supporting documents as to date, payee, amount and account distribution; determine whether supporting documents have been marked to prevent reuse.
- Determine whether the signatures on paid checks are authorized.
- Compare endorsements with the named payees and investigate double or other unexpected endorsements.
- Examine payments of balances subsequent to the balance sheet date to verify recorded payables.

- Test the account classifications of cash disbursements.
- Test the posting of individual cash disbursements from the cash disbursements register to the appropriate accounts in the subsidiary ledgers.
- Test the mathematical accuracy of the cash disbursements register.
- Test the postings of the totals in the cash disbursements register to the general ledger and subsidiary ledgers.

➤ **Purchases application:**

- Compare goods and services ordered (purchase orders and purchase requisitions) to vendors' invoices.
- Compare evidence of goods and services received to vendors' invoices.
- Compare vendors' invoices to the initial record of entry (voucher register).
- Examine vendors' invoices, receiving reports, or other documents supporting the account balances.
- Compare the voucher register to vendors' invoices.
- Compare vendors' invoices to purchase orders and purchase requisitions, receiving documents, or evidence of receipt of services.
- Compare the prices on purchase orders and vendors' invoices with those in vendors' catalogs.
- Test the mathematical accuracy of invoices.
- Review the accounts payable account in the general ledger for unusual items.
- Review the voucher register and cash disbursements register for unusual items; investigate any such items observed.
- Test the posting of individual purchases in the voucher register to the vendors' ledger accounts as to the proper vendor, invoice number, date and amount.
- Test the mathematical accuracy of the voucher register.
- Test the posting of the totals in the voucher register to the general ledger and subsidiary ledgers.

2.7 Accrued Liability and deferred Income

The principal objectives in auditing accrued liabilities and deferred income, and the related income and expense accounts, are to determine whether:

- All accrued liabilities on the balance sheet have accrued or are real debts of the entity, and all deferred income on the balance sheet represents income that is appropriately deferred to future periods, (Existence financial statement assertion).
- All liabilities that have accrued at the balance sheet date and all income that is appropriately deferred to future periods are included on the balance sheet, (Completeness financial statement assertion).
- Accrued liabilities and deferred income are included on the balance sheet at the appropriate amounts, and deferred income is being allocated to the periods in which it is earned, (Valuation financial statement assertion).
- The accrued liabilities on the balance sheet represent obligations of the entity at the balance sheet date which are not secured by liens on assets, security interests, or other collateral nor have they been assumed or guaranteed by others unless otherwise indicated, (Rights and Obligations financial statement assertion).
- Accrued liabilities and deferred income are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.7.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures:

- Compare the account balances with those of prior periods and investigate any unexpected changes (or the absence of expected changes).
- Accrued expenses:
 - Compare the current period's ratio of expense to sales with prior periods' ratios and with competitors' ratios.

B. Tests of Detail:

- Review the accrued liability and deferred income accounts in the general ledger for unusual items.
- Examine the composition and the computation of the accrued liabilities account balances.
- Compare the accrued liabilities at the beginning and end of the period and determine that the accounting is consistent.
- Examine minutes, agreements, contracts, invoices, and other documents supporting accruals and deferred income. Review also for evidence of the existence of liabilities that should be accrued and of income that is appropriately deferred to future periods.
- Test the support for charges to the accrued liability accounts during the period.
- Reconcile the amounts credited to the accrued liability accounts during the period with the related expense accounts.
- Examine payments of accrued liabilities subsequent to the end of the period.
- Search for unrecorded accrued liabilities.
- Examine the composition and the computation of the deferred income account balances and determine whether the bases for deferring income to future periods are appropriate.
- Compare the deferred income accounts at the beginning and end of the period and determine whether the accounting is consistent.

2.8 Long Term Debts Audit Program

The principal objectives in auditing long-term debt and the related interest expense are to determine whether:

- All long-term debt on the balance sheet is real debt due to creditors of the entity. All recorded interest on long-term debt has accrued at the balance sheet date, (Existence financial statement assertion).

- All the entity's long-term debt at the balance sheet date has been recorded. All related interest expense which has accrued at the balance sheet date has been recorded, (Completeness financial statement assertion).
- Long-term debt is included on the balance sheet at the appropriate amounts. Interest expense is stated on the income statement at the appropriate amount, (Valuation financial statement assertion).
- The long-term debt on the balance sheet represents obligations of the entity at the balance sheet date. Unless otherwise indicated, the debt is not secured by liens on, pledges of, or security interests in assets or by other collateral, nor has the long-term debt been assumed or guaranteed by others. There has been compliance with the provisions of debt agreements, (Rights and Obligations financial statement assertion).
- Long-term debt and related accounts for discount, premium, debt issuance costs, and interest are properly classified, described and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.8.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures:

- Compare the account balances with those of prior periods and investigate any unexpected changes (or the absence of expected changes).
- Perform an overall test of the reasonableness of interest expense by multiplying the average interest rate by the average amount of debt outstanding.

B. Tests of Details ("Perform Tests of Details"):

- **Common procedures (procedures that are considered on all audits. Negative results from performing such procedures could indicate matters requiring further investigation.):**
 - Review minutes, agreements, bank confirmation replies or other documents to verify the authorization of long-term debt and to identify the existence of long-term lines of credit.
 - Review leases for proper classification as capital or operating.
 - Prepare or review the schedule of maturities.

➤ **Specific procedures (procedures that provide assurance for particular audit objectives):**

- Inspect original or authenticated copies of notes, debt agreements, or other related documents to determine the terms, restrictive covenants, and other pertinent provisions of long-term debt.
- Identify liens, security interests and assets pledged as collateral for debt by confirmation with the debt holders or, if necessary, the appropriate public filing offices or by inspection of the public records.
- Confirm long-term debt as to the amounts owed and in sinking funds, terms, collateral, restrictions, and the debtor's compliance with the provisions of indentures.
- Review calculations and other evidence relating to compliance with the terms, restrictive covenants, or other provisions of debt agreements. In the case of noncompliance, review any waivers obtained and ascertain that debt is properly classified.
- Review refinancing agreements and long-term debt transactions subsequent to the balance sheet date to determine their effects on balance sheet classification or on disclosure.

C. Other procedures responsive to the evaluation of routine data processes:

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when SAI have evaluated the controls as "effective" and tested them and found that it can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The auditors should consider performing these types of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is "moderate" or "high" since in such circumstances they would have assessed inherent risk as higher), and are more likely to perform them when they have evaluated the controls as ineffective, particularly when they have assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

➤ **Cash receipts and cash disbursements applications:**

- Examine cash receipts or other accounting records to verify additions to long-term debt during the period.
- Review the long-term debt and related accounts (e.g., discount, premium, debt issuance costs, and interest) in the general ledger for unusual items.
- Inspect canceled notes and bonds and/or examine cash disbursements or other accounting records to verify long-term debt paid or canceled during the period.
- Test interest paid, imputed and accrued and amortization of bond premium or discount and debt issuance costs during the period.

2.9 Contingencies

The principal objectives in auditing contingencies are to determine whether:

- All contingencies reflected in the financial statements, including notes, exist, (Existence financial statement assertion).
- All contingencies have been reflected in the financial statements, including notes, to the required extent (Completeness financial statement assertion).
- Contingencies have been included in the financial statements, including notes, at the appropriate amounts (Valuation financial statement assertion).
- Contingencies are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles (Presentation and Disclosure financial statement assertion).

2.9.1 ILLUSTRATIVE PROCEDURES

- Inquire of and discuss with management the entity's policies and procedures for identifying, evaluating, and accounting for contingencies, including those resulting from litigation, claims, and unasserted claims. The inquiry should consider addressing oral arrangements, such as an oral guarantee of the debt of others, as well as written arrangements.
- Review the results of audit procedures performed for other accounts.
- Read the minutes of corporate meetings (e.g., shareholders, board of directors and relevant committees of the board) held during the period being examined and through to the date of SAI Auditors' report.
- Read significant contracts, loan agreements, leases, correspondence from tax and other regulatory authorities, service guarantees, insurance policies (or note the lack of insurance), and other applicable documents.
- Determine, through inquiry and review of sales and/or lease agreements, policies in effect with respect to returns, repurchases, and future allowances applicable to sales or leases.
- Examine returned standard bank confirmation forms and any other returned confirmations of bank credit arrangements for contingent liabilities, letters of credit, and compensating balance arrangements. Consider inquiry (orally or by supplementing the confirmation request) of the financial institution, including the institution's lending officer servicing the entity's account, about oral, as well as written, guarantees of the debt of others.
- Obtain from management or legal counsel a description and evaluation of the litigation, claims and unasserted claims that existed at the balance sheet date and during the period from the balance sheet date to the date the information is provided to SAI Auditors.
- Obtain written representation from management that the list of unasserted claims provided to SAI Auditors (and included in the inquiry letter sent to legal counsel) includes all unasserted claims that management has been advised by legal counsel are probable of assertion and which are required to be disclosed.
- Examine documents, including correspondence and invoices from lawyers, in the entity's possession concerning litigation, claims, and unasserted claims.
- Obtain and evaluate letters from legal counsel.

- Evaluate the principal assumptions underlying management's estimates of the outcomes and effects of contingencies, and the reasonableness of the amounts/disclosures to be included in the financial statements.
- Review rationale and supporting data and computations for additions to estimated liability for self-insurance claims. Compare relationship of provision to claims made during the period. (Request this information through the entity, from an actuary or risk management consultant, if applicable.)
- Obtain the entity's representation regarding contingencies and an update of unasserted claims to the date of SAI Auditors' report as part of the financial statement representation letter. Consider adding a reference to oral and written guarantees to the contingent liabilities section of the letter.

2.9.2 GUIDANCE SUPPLEMENTING ILLUSTRATIVE PROCEDURES

The illustrative procedures for auditing contingencies are principally performed in connection with other phases of the audit. Many of the sections on account balances include illustrative procedures aimed at identifying contingencies. Accordingly, SAI should remain alert for contingencies throughout the audit, and perform few additional procedures aimed solely at identifying contingencies.

A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur (IAS No. 10, "Events Occurring After the Balance Sheet Date").

IAS No. 10 states that contingencies in gains should not be recognized as income or as an asset in the financial statements. The existence of contingent gains should be disclosed if it is probable that the gain will be realized.

A loss contingency may result from the loss or impairment of an asset or the incurrence of a liability. Examples of loss contingencies include:

- Risk of loss or damage of property by fire, explosion, or other hazards;
- Threat of expropriation of assets;
- Pending or threatened litigation against the entity;
- Actual or possible claims;
- Risk of loss from catastrophes assumed by property and casualty insurance companies including re-insurance companies;
- Guarantees of indebtedness of others (direct or indirect), including guarantees of the maintenance of net worth or working capital of affiliates;
- Obligations of commercial banks under "standby letters of credit";
- Agreements to repurchase receivables (or to repurchase the related property) that have been sold;
- Collectability of recorded receivables; and
- Obligations related to product warranties and product defects.

The objectives of the procedures are to identify contingencies and evaluate the appropriateness of the entity's accounting and/or disclosure with respect to them. When a loss contingency has been identified, SAI should evaluate management's determination of whether the likelihood of loss from the contingency is probable, reasonably possible, or remote (as defined in IAS No. 10) and whether the amount of loss can be reasonably estimated.

2.9.3 Documentation

Documentation includes, but is not limited to, identification of the following:

- The procedures performed (generally the audit program or references to it) and conclusions reached with respect to the procedures performed, together with a statement of overall conclusions with respect to contingencies;
- The policies and procedures used by management for identifying, evaluating, and accounting for contingencies;

- The problems encountered and bases of resolution; and
- To the extent appropriate, the following:
 - Descriptions of the various contingencies of which the auditors are aware;
 - Evaluation of the need to account for and/or disclose the contingencies in the financial statements or notes;
 - Memoranda of discussions regarding contingencies with officers and employees of the entity and its counsel;
 - Letters received from counsel (ordinarily filed in section A of the working papers); and
 - Entity representation letters (ordinarily filed in section A of the working papers).

2.10 Revenue (sales)

The principal objectives in auditing revenues are to determine whether:

- All sales included in the income statement represent the exchange of goods or services with customers for cash or other consideration during the period. All other revenues included in the income statement for the period have accrued to the entity at the balance sheet date. Revenues applicable to future periods have been deferred, (Existence, Measurement and Occurrence financial statement assertions).
- All sales and other revenues that accrued to the entity during the period are included in the income statement, (Completeness financial statement assertion).
- Sales and other revenues are stated in the income statement at the appropriate amounts. (Valuation financial statement assertions).
- Sales and other revenues are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.10.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures (“Perform Analytical and Data Analysis Procedures”).

➤ General:

- Compare the monthly income statements and investigate any unexpected fluctuations (or absence of expected fluctuations).
- Review the entity's comparisons of budgeted and actual revenues by month or by quarter; corroborate some of the reasons identified by the entity for important variations; investigate any unexpected variations (or the absence of expected variations) that were not identified by the entity.

➤ Sales:

- Compare sales to the current year's budget and to prior periods' actual sales by product line or geographic area.
- Compare sales volume to industry output in total or by geographic area (e.g., exports).
- Compare gross profit ratios with prior periods by product line or geographic area (e.g., exports); compare other operating relationships (e.g., both sales and cost of sales to units shipped) with prior periods.
- Compare sales for several days prior to and after year end to the average daily sales for the year.
- Compare the current period's sales returns and allowance for sales returns as percentages of sales by product line with prior periods' percentages.
- Compare the number and amounts of credits issued with those of prior periods.
- Review the relationships between sales and cost of sales, such as gross profit analyses, comparisons of standards and actual costs, and reconciliations between cost of sales and outgoing shipments.
- Review the relationships between certain types of expenses and sales (e.g., freight-out to units billed and sales bonuses to sales).

- If inventory overstatement can result from unbilled inventory, observe physical inventory at or near year end. Arrange for heavy coverage of counts. Investigate book-to-physical adjustments.
- Compare the volume of cash sales with corresponding days or periods in prior years. Investigate any unexpected changes or the absence of expected changes.
- Review gross margins from cash sales and compare with prior periods.

➤ **Other revenue:**

- Perform an overall test of revenue (e.g., published tuition rates for a school times the number of students, by classification).
- Perform an overall test of interest and dividend income on investments and receivables (e.g., by multiplying the average amounts invested or receivable by average interest rate or dividend yields).

B. Tests of Details:

Common procedures (procedures that are to be considered for all audits. Negative results from performing such procedures could indicate matters requiring further investigation.

➤ **Sales:**

- Observe procedures for recording cash sales transactions and safeguarding cash receipts.
- Inquire about management, salespersons, or others receiving products without billing or payment.
- Determine rights of return offered to customers under the terms of sales agreements or as a matter of practice.

➤ **Other revenue:**

- Obtain detailed analyses of selected revenue accounts and trace the details to the source data.
- Review the marketable securities and related accounts (e.g., interest and dividend income) in the general ledger for unusual items.
- Test accrued interest and interest earned during the period on receivables; determine whether interest should be imputed on long-term receivables arising during the period.
- Examine the support for the charges to the other noncurrent credit accounts in the balance sheet during the period.
- Review reconciliations of the amounts credited or charged to the other noncurrent credit accounts in the balance sheet during the period with the related income or expense accounts.
- Review the other noncurrent credit accounts in the general ledger for unusual items.
- Review the investments and related accounts (e.g., interest and dividend income) in the general ledger for unusual items.
- Verify interest and dividend income on marketable securities, investments, and equity in earnings (losses) of investees by calculating interest earned or by referring to published records of dividends paid or to the financial statements of investees.

- Verify computations of gains and losses from sales of marketable securities and investments.
- Verify calculation of amortization of bond premium or accumulation of bond discount.
- Verify that interest and dividend income earned on obligations of or investments in affiliates agree with the corresponding amounts in the affiliates' records.
- Inspect authorizations and other data supporting retirements, sales, and other disposals of property, plant, and equipment and test the computations of the resulting gains and losses.
- Identify and examine items that may require separate disclosure in the financial statements, including the notes thereto (e.g., extraordinary items, discontinued operations, segment information, gains or losses on foreign currency transactions).
- Verify earnings per share computations.
- Review minutes, agreements, union contracts, budgets and plans for evidence of new sources of revenues that may have been earned. Investigate significant items noted.

Specific procedures (procedures that provide assurance for particular audit objectives):

➤ **Confirm accounts receivable.**

If accounts are confirmed at an interim date, review the “roll-forward” of activity from the confirmation date to the balance sheet date and compare level of activity with prior periods.

Investigate unusual items; consider confirming (at the balance sheet date) significant new accounts and those accounts with significant increases or decreases between the confirmation date and the balance sheet date.

Examine subsequent cash receipts, shipping records, sales contracts, and other evidence to verify the validity of accounts receivable for which replies to confirmation requests are unsatisfactory or were not obtained or as part of supporting year-end receivables balances.

Test the cutoffs of revenues by inspecting the sales register, billings, shipping documents, and other supporting documents immediately before and after the cutoff date, and determine that the transactions were recorded in the proper period; compare the cutoffs of revenues with cutoffs in related areas (e.g., receivables and inventories).

C. Other procedures responsive to the evaluation of routine data processes:

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when SAI have evaluated the controls as “effective” and tested them and found that it can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The auditors should consider performing these types of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is “moderate” or “high” since in such circumstances they would have assessed inherent risk as higher), and are more likely to perform them when they have evaluated the controls as ineffective, particularly when they have assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

➤ **Sales application:**

- Perform a proof of cash by reconciling activity per entity records to activity per the bank. Correlate activity with recorded sales for the year and the change in the Accounts Receivable balance. (Effectiveness of procedures is limited to less complex engagements.)
- Test the records of products ordered and shipped to the sales records; agree dates, customers, products, quantities, prices and amounts.
- Test the posting of individual sales invoices to the sales register and to the customers' ledger.
- Account for the numerical sequence of sales invoices, sales orders and shipping documents during a specific period.
- Test recorded sales to the records of products shipped; agree dates, customers, products, quantities, prices and amounts.
- Investigate large or unusual credit memos issued subsequent to the balance sheet date.
- Review the accounts receivable, sales, and returns and allowances accounts in the general ledger for unusual items.
- Review the sales register, the sales returns and allowances register, and the cash receipts register for unusual items; investigate any such items observed.
- Test the pricing and mathematical accuracy of sales invoices.
- Test the accounting classification of sales transactions.
- Test the mathematical accuracy of the sales register.
- Trace the accounts receivable to the customers' ledgers; investigate reconciling items.
- Test the postings of the totals in the sales register to the general ledger and the customers' ledger.

➤ **Sales returns and allowances (credit memos) application:**

- Compare credit memos and supporting documents with the sales returns and allowances register as to dates, customers, products, quantities, prices and amounts.
- Account for the numerical sequence of credit memos during a specified period.
- Test the posting of individual credit memos to the sales returns and allowances register and to the customers' ledger.
- Compare recorded credit memos with the documents supporting returns and allowances as to dates, customers, products, quantities, prices and amounts.
- Test the authorization of credits, discounts and allowances shown in the cash receipts register.
- Test the pricing and mathematical accuracy of credit memos.
- Test the cutoff in processing credits and allowances granted to customers.
- Test the timeliness with which credits granted to customers are processed.
- Test the accounting classification of credit memos.
- Test the mathematical accuracy of the sales returns and allowances register.

- Test the postings of the totals and the sales returns and allowance register to the general ledger and the customers' ledger.
- Test and evaluate the procedures for approving customers' credit and for collecting past due accounts.
- Test and evaluate the procedures for approving credits and allowances granted to customers.

➤ **Cash receipts application:**

- Test invoices and other original records of cash sales transactions to recorded cash sales, and recorded cash sales to supporting documents.
- Compare lists of cash receipts with the entries in the cash receipts register as to date, source, amount and account distribution.
- Compare the details of duplicate deposit slips with the entries in the cash receipts register. Investigate abnormal delays in depositing cash receipts.
- Compare the total amounts of daily deposits shown on the bank statements with the totals of the daily cash receipts shown in the cash receipts register. Investigate unusual delays in depositing cash receipts and any splitting of daily cash receipts into separate deposits.
- Test the recording of miscellaneous receipts (i.e., receipts not usually recorded as routine sales, such as scrap and royalties); consider whether the recorded amounts are reasonable.
- Compare entries in the cash receipts register (e.g., date, source, amount and account distribution) with lists of cash receipts, duplicate deposit slips and bank statements.
- Test the accounting classifications of cash receipts.
- Test the mathematical accuracy of the cash receipts register.
- Test the postings of the totals in the cash receipts register to the general ledger.
- Test the authorization of credits, discounts and refunds in the cash receipts register.
- Perform cash counts on a surprise basis and reconcile counts to cash register tape.
- Investigate large or unusual refunds issued subsequent to the balance sheet date.
- Review cash receipts register and cash accounts in the general ledger for unusual items. Investigate any such items observed.
- Test the mathematical accuracy of sales invoices or other source documents for cash sales.
- Examine the entity's bank reconciliations (or prepare the reconciliations). When appropriate, e.g., to determine whether receipts or disbursements are recorded on a timely basis, or to verify the appropriateness of reconciling items, obtain cutoff bank statements.
- Confirm cash held by others (e.g., bank balances and/or overdrafts); count or confirm cash on hand, if significant.
- Test cutoff of cash receipts, cash disbursements, and transfers at the balance sheet date.

2.11 Cost and Expenses Audit Program

The principal objectives in auditing costs and expenses are to determine whether:

- All costs and expenses in the income statement are properly supported as charges against the entity in the period and are appropriately matched with revenues. Costs and expenses applicable to future periods are carried forward as inventories, prepaid expenses, deferred charges, or property, plant, and equipment, (Existence, Measurement and Occurrence financial statement assertions).
- All costs related to the current period's revenues and all expenses of the current period are included in the income statement, (Completeness financial statement assertion).
- Costs and expenses are stated in the income statement at the appropriate amounts, (Valuation financial statement assertion).
- Cost and expenses are properly classified, described, and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertion).

2.11.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures (Perform Analytical and Data analysis Procedures”):

➤ Cost of sales

- Compare the current period's gross profit ratios (by month, by location, by product, and by geographic area) with those of prior periods and with budgeted amounts; investigate any large or unusual variations or the absence of expected variations.
- Review the relationship with respect to the flow of goods, such as gross profit analysis, comparison of standard and actual costs, and review of the reconciliation between costs of sales and shipments.
- Compare the relationships of materials cost, direct labor cost, and overhead cost to cost of sales with prior periods. Investigate significant fluctuations or the absence of expected fluctuations.
- Compare the relationship of overhead costs in cost of sales to direct labor (hours and/or dollars) with prior years.
- Compare units purchased to units sold. Investigate significant or unusual differences. Ensure that any differences noted are accounted for in the change in inventory during the year.
- Compare the relationship of direct labor costs to number of employees with prior periods. Investigate significant fluctuations.
- Compare average production and average compensation per employee with prior years. Investigate significant fluctuations or the absence of expected fluctuations.

➤ **Expenses**

- Review the entity's comparisons of budgeted and actual costs and expenses, by month or by quarter; corroborate the reasons identified by the entity for important variations; investigate any unexpected variations (or the absence of expected variations) that were not identified by the entity.
- Compare royalty expenses with the related sales.
- Compare sales commissions or bonuses with the related sales.
- Compare the current period's relationship of administrative payroll to direct labor with prior years. Investigate any unexpected variations (or the absence of expected variations).
- Compare the current period's relationship of employee benefits to payroll, hours worked, or number of employees with prior years. Investigate any unexpected variations (or the absence of expected variations).
- Compare the current periods' relationship of pension contribution to covered employees with prior years. Investigate any unexpected variations (or the absence of expected variations).
- Perform an overall test of interest expense by multiplying the average debt outstanding by the weighted average interest rate.
- Compare the current period's depreciation with the prior periods' and with budgeted amounts and with property, plant, and equipment balances.

B. Tests of Details:

Negative results from performing such procedures could indicate matters requiring further investigation.

- Review the expense accounts in the general ledger for unusual items; investigate any such items observed.
- Review components of significant prepaid and accrual accounts for reasonableness if not significant. If not significant compare prepaid expense and accrued liability balances with those of prior periods. Investigate significant fluctuations (or the absence of expected fluctuations).
- Review minutes, agreements, union contracts, budgets and plans for evidence of new types of expenses that may have been incurred. Investigate significant items noted.
- Identify and examine items that may require separate disclosure in the financial statements, including the notes thereto (e.g., extraordinary items, discontinued operations, and segment information).
- Review journal vouchers on a test basis for unusual items; investigate any such items observed.
- Review the voucher register for unusual items; investigate significant items noted.
- Review allocation of expense to departments for reasonableness.
- Trace the total of detailed listing of accounts payable to the total accounts payable in the general ledger.
- Trace a sample of sales transactions to corresponding commissions (or other sales expense).

C. Specific procedures (procedures that provide assurance for particular audit objectives):

- Compare the current year's expenses to the prior year's actual and the current year's budgeted amount (in absolute dollars and/or as a percentage of sales). Investigate any unexpected changes (or absence of expected changes).
- If expenses are audited at interim, review the roll forward of activity from interim to year end and compare it to the activity in the equivalent period of the prior year. Investigate any unexpected changes (or the absence of expected changes).◇ Consider the need to test interim transactions.
- Review interim financial reports and investigate fluctuations (or the absence of expected changes).
- Perform an overall test of payroll expense by:
 - Comparing the average rates per employee or per hour by group (union, nonunion etc.) to the prior year or to the union contract;
 - Analyzing labor variances from standard costs; and
 - Reviewing the number of employees and the year-to-date listing of amounts per employee.

D. Other procedures responsive to the evaluation of routine data processes:

The following are examples of procedures that may, together with, or in place of, the procedures previously discussed, be useful in achieving the principal account balance audit objectives when the evaluation of routine data processes indicates possible errors. These procedures are not performed when SAI have evaluated the controls as "effective" and tested them and found that it can rely on them, or when other substantive procedures can provide sufficient assurance as to whether the errors in question have occurred. The auditors should consider performing these types of procedures when they have evaluated the controls as effective, but have not tested them (especially when the combined risk assessment for the account is "moderate" or "high" since in such circumstances they would have assessed inherent risk as higher), and are more likely to perform them when they have evaluated the controls as ineffective, particularly when they have assessed the combined risk as high.

The timing and extent of procedures performed are responsive to the risk assessment.

Obtain detailed analyses of selected cost and expense accounts and trace the details to the source data.

The following procedures have been written in the context of a check-based banking system.

➤ **Cash disbursements application:**

- Examine the entity's bank reconciliations (or prepare the reconciliations). Where appropriate, e.g., to determine whether receipts or disbursements are recorded on a timely basis, or to verify the appropriateness of reconciling items, perform bank reconciliation cutoff procedures.
- Account for the numerical sequence of checks issued during a specific period.
- Test the comparability of paid checks and supporting documents with the cash disbursements register as to date, payee, amount and account distribution; determine whether supporting documents have been marked to prevent reuse.
- Test vendor invoices to the cash disbursements register.
- Compare goods and services ordered (purchase orders and purchase requisitions) to vendors' invoices.
- Compare evidence of goods and services received to vendors' invoices.
- Test the comparability of entries in the cash disbursements register with the paid checks and supporting documents as to date, payee, amount and account distribution; determine whether supporting documents have been marked to prevent reuse.
- Test cash disbursements journal to vendor invoices.
- Examine vendors' invoices, receiving reports, or other documents supporting the account balances.
- Compare vendors' invoices to purchase orders and purchase requisitions, receiving documents, or evidence of receipt of services.
- Consider the reasonableness of the quantities and the business purposes of the items purchased.

- Compare the prices on purchase orders and vendors' invoices with those in vendors' catalogs.
- Test the mathematical accuracy of invoices.
- Test cutoff of disbursements and transfers at the balance sheet date.
- Examine payments of expenses subsequent to the balance sheet date.
- Test the account classifications of cash disbursements.
- Test the mathematical accuracy of the cash disbursements register.
- Test posting of items in the cash disbursements register to supporting documentation.
- Test the postings of the totals in the cash disbursements register to the general ledger and subsidiary ledgers.

➤ **Purchases application:**

- Confirm accounts payable.
- Test the cutoff by inspecting the voucher register, receiving records, vendors' invoices and other supporting documents immediately before and after the cutoff date and determine that the transactions were recorded in the proper period; compare payables cutoff to cutoff in related areas (e.g., accounts payable and inventories).
- Perform a search for unrecorded liabilities as of the inventory date and/or year end by selecting subsequent disbursements and unmatched invoices and receiving reports to examine.
- Compare vendors' invoices to the initial record of entry (voucher register).
- Examine payments of balances subsequent to the balance sheet date to verify recorded payables.
- Compare entries in the voucher register to vendors' invoices.
- Test the account distributions of purchases in the voucher register by comparing the nature of the goods or services purchased with the descriptions of the accounts.
- Test the mathematical accuracy of the voucher register.
- Test posting of items in the voucher register to supporting documentation.
- Test the postings of the totals in the voucher register to the general ledger and subsidiary ledgers.

➤ **Payroll application:**

- Examine or prepare a bank reconciliation of the payroll cash account and where needed perform cutoff procedures.
- Account for the numerical sequence of paid payroll checks during a specified time period.
- Compare the payrolls at the beginning and end of the period to identify changes in employees and in pay rates.
- Compare hours paid with the record of hours worked (e.g., time cards).
- Trace the payroll checks to the payroll register.
- Agree the record of labor performed (time cards or job tickets) to the labor cost distribution or to the payroll register.
- Obtain a list of employees who left during the period from a source other than the payroll department (e.g., the personnel department), and determine that the former employees were removed from the payroll on a timely basis.
- Observe, on a surprise basis, the distribution of payroll checks to employees.
- Investigate the handling of unclaimed payroll checks.
- Compare employee data (e.g., name, identification number, department, employee status or group, location, wage rate, deductions) to authorizations on file (e.g., hiring records, personnel files on wage rates and reductions, union contracts, and authorization for ♦ income tax withholding).
- Compare names, net pay and other data in the payroll register to the cancelled payroll checks. Examine endorsement(s) on payroll checks and compare them to specimen signatures in the personnel files; investigate unusual or multiple endorsements.
- Test the extensions of the wage rates times the hours worked.
- Test the mathematical accuracy of the individual labor cost distributions.
- Review that the hours on the record of labor performed (e.g., time cards or job tickets) are recorded in the payroll register or the labor distribution journal in the correct period.
- Reconcile the accrued payroll balance to the amount in the payroll register for the corresponding period.
- Examine payments of accrued payroll liabilities and/or payroll disbursements subsequent to the end of the period.
- Review the appropriateness of the labor cost distributions based on the nature of the work performed (e.g., examine time cards or job tickets).
- Test the mathematical accuracy of the payroll register and the labor cost distribution.
- Compare the labor cost distribution totals to the payroll register.
- Test the postings of the totals in the payroll register and the labor cost distribution to the general ledger and the subsidiary ledgers.

2.12 Shareholders Equity Audit Program

The principal objectives in auditing shareholders', partners', or proprietor's equity accounts are to determine whether:

- All the equity accounts on the balance sheet either (a) represent shares or other units of ownership that are appropriately authorized, issued, and outstanding; or (b) reflect other properly authorized transactions that are appropriately recorded in the equity accounts, (Existence financial statement assertion).
- All the shares or other units of ownership that are appropriately authorized, issued, and outstanding, and all other properly authorized transactions that affect the equity accounts at the balance sheet date are included in the equity accounts, (Completeness financial statement assertion).
- The equity accounts are stated on the balance sheet at the appropriate amounts, (Valuation financial statement assertion).
- Stock options, stock purchase plans, stock purchase warrants, conversion privileges, or other contingent share issuances that exist have been appropriately recognized, (Existence, Completeness, Valuation and Presentation and Disclosure financial statement assertions).
- The equity accounts are properly classified, described and disclosed in the financial statements, including notes, in conformity with prescribed accounting principles, (Presentation and Disclosure financial statement assertions).

2.12.1 ILLUSTRATIVE PROCEDURES

A. Analytical procedures ("Perform Analytical and Data Analysis Procedures"):

- Compare the account balances with those of prior periods and investigate any unexpected changes (or the absence of expected changes).

B. Tests of Details:

Negative results from performing such procedures could indicate matters requiring further investigation.):

- Review the equity accounts in the general ledger for unusual items.
- Review the applicability of the financial provisions of the articles of incorporation, charter, bylaws, loan agreements, recapitalization plans, contingent stock issuance agreements, partnership agreements, and other documents to the activity in the equity accounts during the period.
- When applicable, review the authorizations for purchases and retirements of treasury shares; inspect or confirm the stock certificates held in the treasury or retired during the period; determine that reacquired evidences of ownership are held in safekeeping.
- Examine canceled dividend checks for agreement with records.
- Request representation from corporate secretary as to shares issued and outstanding.
- Support details of schedules of shares under option and dollar values by reference to board or authorized committee minutes, provisions of stock plans, or market value quotations.

- Obtain the opinion of legal counsel to determine whether changes in capitalization during the period meet legal requirements.
- Examine the transactions in the equity accounts subsequent to the balance sheet date for adjustments that should be reflected or disclosures that should be made in the financial statements.

➤ **Specific procedures (procedures that provide assurance for particular audit objectives):**

- Confirm the capital stock authorized and issued and, when applicable, the treasury shares held with the transfer agent and registrar; confirm the partners' or the proprietor's account balances.
- If the entity acts as its own transfer agent, examine the stock certificate book or the detailed records to determine the numbers of authorized shares and outstanding shares; inspect unused certificates on hand; test the issuance and cancellation of shares during the period.
- Review the minutes and other supporting documents for the authorization for, and the details of, the transactions that affected the equity accounts during the period, including equity restrictions.

2.12.2 GUIDANCE SUPPLEMENTING ILLUSTRATIVE PROCEDURES

I. Legal Considerations

During the audit of the equity accounts, particularly those of a corporate entity and to a somewhat lesser extent those of a partnership, the auditors may become involved with government statutes and regulations, the articles of incorporation, the charter, the bylaws, and a variety of contracts and agreements. In such circumstances, SAI may request the entity's legal counsel to assist in, or express an opinion on, such matters. Ordinarily, such assistance or opinions are needed only with respect to transactions in the period being audited.

II. Capital Stock Records

SAI should consider obtaining confirmations of the numbers of shares of stock authorized and issued from the transfer agent and the registrar engaged by the entity. If the entity maintains the shareholder records, the auditors should examine the stock certificate book or the detailed records to determine the number of shares issued and the number of shares held as treasury stock.

On occasion, entities (usually smaller entities) may not maintain detailed records to support authorized and issued shares, choosing instead to use standard unnumbered forms of certificates when shares are issued. The absence of a formal record may require the auditors to select alternative procedures to verify the capital stock information. Records relating to the organization (and changes in the organization) of corporate entities may be maintained by government bodies, and information regarding authorized shares may be obtained from these sources. In such circumstances, information on issued shares may be obtainable only by confirmations from the owners of the shares or from management.

III. Transactions in Capital Stock

Auditors should review transactions involving the sale, purchase, issuance, investment tenders, and issuance of shares in privatization programs, or retirement of capital stock to determine that they have been authorized and appropriately reflected in the financial statements. Capital stock transactions take many forms (e.g., donated stock, treasury stock, stock dividends and stock splits, employee stock transactions), and they should refer to the applicable authoritative pronouncements in the audit of the transactions.

IV. Separate Components of Equity

Under existing tax laws, revaluations of properties are permitted. Such revaluations are included in the stockholders' equity section of the balance sheet. Under the provisions of IAS No. 21, "The Effects of Changes in Foreign Exchange Rates," foreign currency translation adjustments are accumulated in a separate component of equity. SAI should determine whether these components of equity and changes in them during the current period are properly recorded.

V. Partnerships

When auditing a partnership, SAI should obtain a basic understanding of the partnership agreement. Information in that document which may be useful includes:

- The basis for sharing profits;
- The basis for partners' contributions of time and assets;
- The levels at which capital must be maintained;
- The basis for making loans to partners; and
- The conditions of withdrawal from the partnership.

If a written agreement does not exist, SAI should consider alternative procedures to obtain such information. Requesting partners to confirm the balances in their accounts or to formally approve the financial statements helps the auditors to obtain satisfaction that the partnership has run its affairs in accordance with the understanding among the partners.

VI. Proprietorships

When auditing the financial statements of a proprietorship, SAI generally will not find formal documents establishing the basis for changes in the capital assigned to the business. Under such circumstances, SAI should obtain satisfaction that changes in the capital accounts are approved by the proprietor and that the nature of the transactions is appropriately disclosed in the financial statements.

1.2.12.1 Documentation

Documentation includes, but is not limited to, identification of the following:

- The procedures performed (generally the audit program or reference to it) and conclusions reached with respect to the procedures performed, together with a statement of overall conclusions with respect to shareholders', partners', or proprietor's equity;
- The relationship of the nature, timing, and extent of procedures performed to the evaluation of the accounting estimation, routine data, and non-routine data processes, or reference to the documentation of such relationship elsewhere in the audit working papers (usually in the planning documents);
- The problems encountered and bases of resolution; and
- To the extent appropriate, the following:
 - Summary of equity accounts and activity in those accounts during the period;
 - Details of capital stock authorized and outstanding, treasury shares held, dividends declared, and other transactions in equity securities during the period;
 - Confirmations of capital stock or of the partners' or proprietor's equity accounts;
 - Result of analytical review procedures performed;
 - Restrictions on equity distributions imposed by regulations, debt agreements, partnership agreements, or other instruments, and computations of the restrictions;
 - Details of investment tenders and the type of assets to be contributed under the terms of the investment tender;
 - Details of stock options, stock purchase plans, stock purchase warrants, conversion privileges, and other contingent share issuances; and
 - Copies, summaries, or extracts of pertinent provisions of minutes, articles of incorporation, charters, bylaws, partnership agreements, legal documents, opinions of counsel, historical analyses of equity accounts, and other documents relating to the equity accounts. Some or all of these items are contained in the permanent file.

3. Glossary

Accounting applications	The methods and records used to (1) identify, assemble, analyze, classify, and record a particular type of transaction or (2) report recorded transactions and maintain accountability for related assets and liabilities. Common accounting applications are (1) billings, (2) accounts receivable, (3) cash receipts, (4) purchasing and receiving, (5) accounts payable, (6) cash disbursements, (7) payroll, (8) inventory control, and (9) property, plant, and equipment (PP&E).
Accounting policies	Principles, bases, conventions, rules and practices to prepare and present financial statements
Accounting system	The methods, records, and processes used to identify, assemble, analyze, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities.
Accrual accounting	Principle whereby transactions and other events are recognized when they occur rather than when related cash or equivalent is received or paid. Such transactions and events are recorded in the accounting records and recognized in the financial statements for the periods to which they relate. Elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.
Activity	The actual work task or step performed in producing and delivering products and services. An aggregation of actions performed within an organization that is useful for purposes of activity-based costing.
Analytical procedures	The comparison of recorded account balances with expectations developed by SAI Auditor, based on an analysis and understanding of the relationships between the recorded amounts and other data, to form a conclusion on the recorded amount. A basic premise underlying the application of analytical procedures is that plausible relationships among data may reasonably be expected to continue unless there are known conditions that would change the relationships or the data are misstated.
Annual financial statement	The annual financial statement comprises: • unaudited Management's Discussion and Analysis (MD&A), • audited basic financial statements, including note disclosures, • unaudited other accompanying information, if applicable.
Application controls	Controls that are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during application processing. Application controls include controls over input, processing, output, master data, application interfaces, and data management system interfaces. These controls are sometimes referred to as business process controls.

Appropriation	Budget authority to incur obligations and to make payments from the Treasury for specified purposes. An appropriation `act is the most common means of providing appropriations; however, authorizing and other legislation itself may provide appropriations. Appropriations do not represent cash actually set aside in the Treasury for purposes specified in the appropriation acts. They represent amounts that agencies may obligate during the period of time specified in the respective appropriation acts.
ARABOSAI	Arab Organization of Supreme Audit Institutions.
Assertions	Management representations that are embodied in financial statement Components. The Financial Audit Manual classifies assertions in the following five broad categories (as described in • Existence or occurrence • Completeness • Rights and obligations • Accuracy/valuation or allocation • Presentation and disclosure.
Assessing control risk	The process of evaluating the effectiveness of an entity's internal control in preventing or detecting misstatements that could be material, either individually or when aggregated with other misstatements, in financial statement assertions on a timely basis.
Assets	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.
Audit Difference	A difference between the amount, classification, or presentation of a Financial Statement element, account, or other item and the amount, classification, or presentation that the auditors believe would be required under generally accepted accounting principles (or other applicable financial reporting framework) or the omission of a financial statement amount, account, or item required under Generally Accepted Accounting Principles (GAAP).
Audit evidence	Information obtained to draw conclusions that support the audit opinion.
Audit Mandate	The auditing responsibilities, powers, discretions and duties conferred on a SAI under the constitution or other lawful authority of a country.
Audit objective	The objective of auditing financial statements is to enable SAI Auditor to express an opinion on whether the financial statements adhere, in all material aspects, to an identified financial reporting framework.

Audit opinion	A clearly written assessment of the financial statements as a whole. An unqualified opinion is expressed when SAI Auditor concludes that the financial statements give a true and fair view, in all material respects, in accordance with the identified financial reporting framework.
Audit Procedures	Tests, instructions and details included in the audit program to be carried out systematically and reasonably.
Audit program	Sets out the nature, timing and extent of planned audit procedures required to implement the audit plan. The audit programme serves as a set of instructions to assistants involved in the audit and as a means to control the proper execution of the work.
Audit sampling	The application of audit procedures to less than 100% of the items within an account balance or class of transactions in order to obtain and evaluate audit evidence about some characteristics of the items. Such evidence must support a conclusion with respect to the entire set of data.
Audit Scope	The framework or limits and subjects of the audit.
Auditing Standards	Auditing standards provide minimum guidance for SAI Auditor that helps determine the extent of audit steps and procedures that should be applied to fulfill the audit objective. They are the criteria or yardsticks against which the quality of the audit results are evaluated.
Assurance, level	The complement of audit risk, which is an auditor judgment. This is not the same as confidence level, which relates to an individual sample.
Attributes sampling	Statistical sampling that reaches a conclusion about a population in terms of a rate of occurrence.
Audit risk	A combination of (1) the risk (consisting of inherent and control risk) that the balance or class and related assertions contain misstatements that could be material to the financial statements when aggregated with misstatements in other balances or classes, and (2) the risk (detection risk) that SAI Auditor will not detect such misstatement.
Back door authority/ Backdoor spending	A colloquial phrase for budget authority provided in laws other than appropriations acts, including contract authority and borrowing authority, as well as entitlement authority and the outlays that result from that budget authority. (See also appropriation and contract authority.)
Borrowing authority	Budget authority enacted to permit an agency to borrow money and then to obligate against amounts borrowed. It may be definite or indefinite in nature. Usually the funds are borrowed from the Treasury, but in a few cases agencies borrow directly from the public.
BSA	Board of State Audit; (if any, it can be applicable)

Budget authority	Authority provided by federal law to enter into financial obligations that will result in immediate or future outlays involving federal government funds. The basic forms of budget authority include (1) appropriations,(2) borrowing authority, (3) contract authority, and (4) authority to obligate and expend offsetting receipts and collections. Budget authority includes the credit subsidy cost for direct loan and loan guarantee programs, but does not include the underlying authority to insure or guarantee the repayment of indebtedness incurred by another person or government.
Budget controls	Management's policies and procedures for managing and controlling the use of appropriated funds and other forms of budget authority.
CAN	Anti-Corruption Network: a group of highly experienced anti-corruption experts who have adapted and applied the methodology described in this Compendium to various country settings with substantive institutions that are front line players and/or stakeholders in the national integrity system.
Cash	Comprises cash on hand and demand deposits.
Cash flow	Inflow and outflow of cash and cash equivalents.
Cause and effect basis	In cost accounting, a way to group costs into cost pools in which an intermediate activity may be a link between the cause and the effect.
Classical probability proportional to size sampling	A type of statistical sampling where the sample is selected with probability proportional to the size (usually dollar amount) of an item and the evaluation is performed using variables methods (not monetary unit sampling).
Classical variables estimation sampling	A sampling approach that measures sampling risk using the variation of the underlying characteristic of interest. This approach includes methods such as mean-per-unit, difference estimation, and ratio estimation.
Closed (canceled) account	An appropriation account whose balance has been canceled. Once balances are canceled, the amounts are not available for obligation or expenditure for any purpose.
Combined precision	The achieved precision for all statistical sampling applications.
Common data source	All of the financial and programmatic information available for the budgetary, cost, and financial accounting processes. It includes all financial and much non-financial data, such as environmental data, that are necessary for budgeting and financial reporting as well as evaluation and decision information developed as a result of prior reporting and feedback.
Compliance control	A process, by management and others, designed to provide reasonable assurance regarding the achievement of objectives for compliance with applicable laws and regulations.

Compliance tests	Tests to obtain evidence on the entity's compliance controls for each significant provision of laws and regulations identified for testing, including budget controls for each relevant budget restriction.
Confidence interval	A statistical sample-based estimate expressed as an interval or range of values. The sample is designed such that there is a specified confidence level for which the population value being estimated is expected to be located within the interval. More specifically, it is the projected misstatement or point estimate plus or minus precision at the desired confidence level and is also known as a precision or precision interval.
Confidence level	The complement of the applicable sampling risk. The measure of probability associated with a sampling interval. This is not the same as level of assurance.
Constitutional	A matter which is permitted or authorized by the fundamental law of a country.
Contingency	An existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur.
Contract authority	Budget authority that permits an entity to incur obligations in advance of appropriations, including collections sufficient to liquidate the obligation or receipts. Contract authority is unfunded, and a subsequent appropriation or offsetting collection is needed to liquidate the obligations.
Contractor	An entity that performs construction work pursuant to a construction contract.
Control activities	One of the five components of internal control, in addition to control environment, risk assessment, information and communications, and monitoring. Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities, whether automated or manual, help achieve control objectives and are applied at various organizational and functional levels.
Control environment	One of the five components of internal control, in addition to risk assessment, control activities, information and communications, and monitoring. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. The control environment represents the collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific control activities. Such factors include (1) integrity and ethical values, (2) commitment to competence, (3) management's philosophy and operating style, (4) organizational structure, (5) assignment of authority and responsibility, (6) human resource policies and practices, (7) control methods over budget formulation and execution, (8) control methods over compliance with laws and regulations, and (9) oversight groups.
Control risk	SAI Auditor's assessment of the risk that a material misstatement that could occur in an assertion will not be prevented or detected on a timely basis by the entity's controls.

Control tests	Tests of a specific control activity to assess its effectiveness in achieving control objectives.
Cost	The monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service.
Data base	A collection of data that is shared and used by a number of different users for different purposes.
Depreciation (amortization)	The systematic allocation of the depreciable amount of an asset over its useful life.
Design material	The portion of planning materiality that SAI Auditor allocates to line items, accounts, or classes of transactions.
Detection risk	SAI Auditor's assessment of the risk that SAI Auditor will not detect a material misstatement that exists in an assertion.
Documentation	The material (working papers) prepared by and for, or obtained and retained by SAI Auditor to conduct the audit.
Due Care	The appropriate element of care and skill which a trained auditor would be expected to apply having regard to the complexity of the audit task, including careful attention to planning, gathering and evaluating evidence, and forming opinions, conclusions and making recommendations.
Economy	Minimizing the cost of resources used for an activity, having regard to the appropriate quality.
Effectiveness	The extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.
Efficiency	The relationship between the output, in terms of goods, services or other results, and the resources used to produce them.
Entity risk assessment	One of the five components of internal control, in addition to control environment, control activities, information and communications, and monitoring. Risk assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed. An entity's risk assessment for financial reporting purposes is its identification, analysis, and management of risks relevant to the preparation of financial statements that are fairly presented in conformity with THE APPLICABLE ACCOUNTING STANDARDS.
Errors Unintentional	Misstatements of amounts or disclosures in financial statements.
Events after reporting date	Favorable and unfavorable events that occur between the reporting date and the date when the financial statements are authorized for issue.
Exchange rate	Rate at which a currency may be converted into another.

Expectation	SAI Auditor's estimate of a recorded amount (based on an analysis and understanding of relationships between the recorded amounts and other data) in an analytical procedure.
Expected-misstatement	The dollar amount of misstatements SAI Auditor expects in a population
Expired account	An account within Treasury to hold expired budget authority. The expired budget authority retains its fiscal year (or multiyear) identify for an additional 5 fiscal years. After the 5-year period has elapsed, all obligated and unobligated balances are canceled, the expired account is closed, and all remaining funds are returned to the general fund of the Treasury and are thereafter no longer available for any purpose.
Fair value	The amount for which an asset can be exchanged or a liability settled between knowledgeable and willing parties in an arm's length transaction.
Field Standards	The framework for SAI Auditor to systematically fulfill the audit objective, including planning and supervision of the audit, gathering of competent, relevant and reasonable evidence, and an appropriate study and evaluation of internal controls.
Financial asset	An asset that is: Cash, a contractual right to receive cash or another financial asset from another entity, a contractual right to exchange financial instruments with another entity under conditions that are potentially favorable or an equity instrument of another entity.
Financial liability	A liability that is a contractual obligation: ☐ to deliver cash or another financial asset to another entity or to exchange financial instruments with another entity under conditions that are potentially unfavorable.
Financial reporting control	A process, created by management and other personnel, designed to provide reasonable assurance regarding the achievement of financial reporting objectives.
Financial statements (also called the basic or principal statements)	A component of a federal entity's annual financial statement (also referred to as the Accountability Report), which consist of : • Balance Sheet • Statement of Net Cost • Statement of Changes in Net Position • Statement of Budgetary Resources • Statement of Custodial Activity (if applicable) • Statement of Social Insurance (if applicable) • Related note disclosures
Financial Systems	The procedures for preparing, recording and reporting reliable information concerning financial transactions.
Findings, Conclusions and Recommendations	Findings are the specific evidence gathered by SAI Auditor to satisfy the audit objectives; conclusions are statements deduced by SAI Auditor from those findings; recommendations are courses of action suggested by SAI Auditor relating to the audit objectives.

Foreign currency	A currency other than the reporting currency of an entity.
Fixed price contract	A construction contract in which the contractor agrees on a fixed price or on a fixed rate per unit of output which is sometime subject to cost escalation clauses.
Fraud	Fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of misstatements resulting from fraud are relevant to SAI Auditor's consideration in a financial statement audit: misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.
Fraudulent financial Reporting	Intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting could involve intentional alteration of accounting records misrepresentation of transactions, intentional misapplication of accounting principles, or other means.
Full cost	The total amount of resources used to produce the output. More specifically, the full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the responsibility segment that directly or indirectly contribute to the output and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities.
Functional classification	A system of classifying budget authority, outlays, receipts, and tax expenditures according to the national needs being addressed. Each concurrent resolution on the budget allocates budget authority and outlays among the various functions. Each budget account appears in the single budget function (for example, national defense or health) that best reflects its major purpose, an important national need. A function may be divided into two or more sub functions, depending upon the complexity of the national need addressed.
Fund Balance with Treasury account (FBWT)	An asset account representing the unexpended spending authority in entity appropriations. Also serves as a mechanism to prevent entity disbursements from exceeding appropriated amounts.
Fundamental	A matter becomes fundamental (sufficiently material) rather than material when its impact on the financial statements is so great as to render them misleading as a whole.
General controls	Management's policies and procedures that apply to all or a large segment of an entity's Information systems. General controls help ensure the proper operation of information systems by creating the environment for proper operation of application controls. General controls include (1) security management, (2) logical and physical access, (3) configuration management, (4) segregation of duties, and (5) contingency planning.
Governance	A code of conduct for people associated with the entity (directors, supervisory board members, investors, etc.) that sets rules for sound management, proper supervision and an adequate division of duties.

Government business enterprise	An entity that has all the following characteristics: has the power to contract in its own name; ☐ has the financial and operational authority to carry on a business; sells goods and services in the normal course of its business to other entities at a profit or full cost recovery; does not rely on continuing government funding as an ongoing concern (other than purchases of outputs at arm's length) and is controlled by a public sector entity.
Haphazard sample	A sample consisting of sampling units selected without any conscious bias, that is, without any special reason for including or omitting items from the sample. It does not consist of sampling units selected in a careless manner and is selected in a manner that can be expected to be representative of the population.
Impairment	A loss in the future economic benefits or service potential of an asset over and above its normal depreciable life.
Independence	The freedom of the SAI in auditing matters to act in accordance with its audit mandate without external direction or interference of any kind.
Information and Communication	One of the five components of internal control, in addition to control environment, entity risk assessment, control activities, and monitoring. The information and communication systems support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their internal control and other responsibilities.
Information Security (IS) controls specialist	A person with technical expertise in information technology systems, general controls, applications, and information security
IS controls	Internal controls that are dependent on information systems processing and include general controls and application controls
Inherent risk	SAI Auditor's assessment of the susceptibility of an assertion to a material misstatement, assuming there are no related controls.
Interdepartmental	Activity and balances between two different departments. (See department.) The intradepartmental and interdepartmental amounts are subsets of intra-governmental activity and balances.
Inter-entity	Activities or balances between two or more entities, departments, or bureaus. (See interdepartmental and intradepartmental.)
Internal Audit	The functional means by which the managers of an entity receive an assurance from internal sources that the processes for which they are accountable are operating in a manner which will minimize the probability of the occurrence of fraud, error or inefficient and uneconomic practices. It has many of the characteristics of external audit but may properly carry out the directions of the level of management to which it reports.

Internal control	An integral component of an organization's management systems that provides reasonable assurance that the following objectives are being achieved: • Effectiveness and efficiency of operations, • reliability of financial reporting, and • compliance with applicable laws and regulations.
International Organization of Supreme Audit Institutions (INTOSAI)	An international and independent body which aims at promoting the exchange of ideas and experience between Supreme Audit in the sphere of public financial control.
Interdepartmental – Amounts	Activity and balances within the same department (see department). The intradepartmental and interdepartmental amounts are subsets of intra-governmental activity and balances.
Intergovernmental amounts	Activity and balances occurring within or between federal entities.
Inventories	List of such assets as: materials or supplies to be consumed in the production process; materials or supplies to be consumed or distributed in the rendering of services; ☐ ☐ materials or supplies for sale or distribution in the ordinary course of operations; or materials or supplies being produced for sale or distribution.
Judgment fund	A permanent and indefinite appropriation administered by the Department of the Treasury that is available to pay judgments, settlement agreements, and certain types of administrative awards against the United States when such payment is not otherwise provided for in entity appropriations.
Key management Personnel	directors or members of the governing body of the entity and other persons having the authority and responsibility for planning, directing and controlling the activities of the reporting entity.
Known misstatement	The specific misstatement identified during the audit arising from the incorrect selection or misapplication of accounting principles or misstatements of facts identified, including, for example, those arising from mistakes in gathering or processing data and the overlooking or misinterpretation of facts.
Lease	An agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time, in return for a payment or series of payments.
Legal obligation	An obligation that derives from: ☐ an explicit or implicit contract, legislation or other legislative enactment.
Legislature	The law making authority of a country, for example a Parliament.

Likely misstatement	A misstatement that: • Arises from differences between management's and SAI Auditor's judgments concerning accounting estimates that SAI Auditor considers unreasonable or inappropriate (for example, because an estimate included in the financial statements by management is outside of the range of reasonable outcomes SAI Auditor has determined). • SAI Auditor considers likely to exist based on an extrapolation from audit evidence obtained (for example, the amount obtained by projecting known misstatements identified in an audit sample to the entire population from which the sample was drawn).
Limit	Used in performing substantive analytical procedures, the limit is the amount of difference between the expectation and the recorded amount that SAI Auditor will accept without investigation. Therefore, SAI Auditor should investigate amounts that exceed the limit during analytical procedures.
Limitation	A restriction on the amount, purpose, or period of availability of budget authority. While limitations are most often established through appropriations acts, they may also be established through authorization legislation. Limitations may be placed on the availability of funds for program levels, administrative expenses, direct loan obligations, loan guarantee commitments, or other purposes.
Logical Unit	The balance or transaction that includes the selected dollar in a probability-proportional-to-size sample.
Management Audit	Analysis of public expenditure in the light of general principles of sound management.
Market Value	The amount obtainable from the sale or payable on the acquisition of a financial instrument in an active market.
Materiality	The magnitude of an item's omission or misstatement in a financial statement that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item (FASB Statement of Financial Concepts No. 2). See planning materiality, design materiality, and tolerable misstatement.
Mean-per-unit Approach	A classical variables sampling technique that projects the sample average to the total population by multiplying the sample average by the total number of items in the population.
Misappropriation of Assets	Theft of an entity's assets causing misstatements in the financial statements.
Monetary items	Cash and other assets and liabilities to be received or paid in fixed or determinable amounts of money.

Monetary unit sampling	A variables sampling evaluation method that utilizes a probability proportional-to-size (PPS) sample selection technique. Since SAI Auditor randomly selects the sample from a population of dollars, large value transactions have more chance of selection and are more likely to be sampled than small-value transactions.
Monitoring	One of the five components of internal control, in addition to control environment, risk assessment, control activities, and information and communications. Monitoring is a process that assesses the quality of internal control performance over time. Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.
Multipurpose testing	Performing several tests, such as control tests, compliance tests, and substantive tests, on a common selection, usually a sample.
NGO	Non-governmental Organization
Non-representative selection	A selection of items to reach a conclusion only on the items selected. SAI Auditor using a non-representative selection (formerly referred to as a non-sampling selection) may not project the results to the portion of the population that was not tested. Accordingly, SAI Auditor applies appropriate analytical and/or other substantive procedures to the remaining items, unless those items are immaterial in total or SAI Auditor has already obtained enough assurance that there is a low risk of material misstatement in the total population. SAI Auditor also uses non-representative selections to test controls through inquiry, observation, and walkthrough procedures and to obtain planning information.
Non-statistical sampling	A sampling technique for which SAI Auditor considers sampling risk in evaluating an audit sample without using statistical theory to measure the risk.
Offsetting receipts and Collections	A form of budget authority that permits agencies to obligate and expend the proceeds of offsetting receipts and collections.
Operating activities	Activities other than investing or financing activities.
Operations controls	A process by management and others, designed to provide reasonable assurance regarding the achievement of objectives for the effectiveness and efficiency of operations.
Opinion	SAI Auditor's written conclusions on a set of financial statements as the result of a financial or regularity audit.
Oversight	The supervision of activities with the authority and responsibility to control or exercise significant influence over financial and operating decisions.
Overall analytical Procedures	Analytical procedures performed as an overall financial statement review during the reporting phase.

Performance Audit	An audit of the economy, efficiency and effectiveness with which the audited entity uses its resources in carrying out its responsibilities.
Planning	Defining the objectives, setting policies and determining the nature, scope, extent and timing of the procedures and tests needed to achieve the objectives.
Planning Materiality	SAI Auditor's preliminary estimate of materiality in relation to the financial statements taken as a whole. It is used to determine design and tolerable misstatement, which are used to determine the nature, extent, and timing of substantive audit procedures. It is also used to identify significant laws and regulations for compliance testing.
Point estimate (estimated value)	Most likely amount of the population characteristic based on the sample.
Population	The items comprising the account balance or class of transactions of interest. The population excludes individually significant items that SAI Auditor has decided to examine 100 percent or other items that will be tested separately.
Precision (allowance for sampling risk)	A measure of the difference between a sample estimate and the corresponding population characteristic at a specified sampling risk.
Preliminary analytical Procedures	Analytical procedures performed during the audit planning phase.
Principles	Basic assumptions, consistent premises, logical principles and requirements which represent the general framework for developing auditing standards.
Principal statements	See financial statements.
Probable	In evaluating a contingency for pending or threatened litigation and unasserted claims, a future confirming event(s) occurring is likely to occur. For other contingencies, the future event or events are more likely than not to occur.
Projected misstatement	An estimate of the misstatement in a population, based on the misstatements found in the examined sample items; represents misstatements that are probable. The projected misstatement includes the known misstatement.
Providing entity	The entity providing services, products, goods, transfer funds, investments, debt, and/or incurring the reimbursable costs. This includes bureaus, departments, and/or programs within entities. The providing agency is the seller. The providing entity transfers out funds to another entity (transfers out) when appropriations are transferred without the exchange of goods or services.
Provision	A liability of uncertain timing and/or amount.
Public Accountability	The obligations of persons or entities, including public enterprises and corporations, entrusted with public resources to be answerable for the fiscal, managerial and program responsibilities that have been conferred on them, and to report to those that have conferred these responsibilities on them.

Random Sample	A sample selected so that every combination of the same number of items has an equal probability of selection.
Ratio Estimation	A classical variables sampling technique that uses the ratio of audited amounts to recorded amounts in the sample to estimate the total dollar amount of the population and an allowance for sampling risk.
Reasonably possible	The chance of the future confirming event or events occurring is more than remote but less than probable.
Receiving entity	The entity receiving services, products, goods, transfer funds, purchasing investments, and/or borrowing from Treasury (or other entities). This includes bureaus, departments, and/or programs within entities. The receiving entity is the purchaser. The receiving entity receives transfers of funds (transfers in) when appropriations are transferred without the exchange of goods or services.
Reciprocal accounts	Corresponding SGL accounts that should be used by a providing/seller and receiving/buyer entity to record like intra-governmental transactions. For example, the providing entity's accounts receivable would normally be reconciled to the reciprocal account, accounts payable, on the receiving entity's records.
Recorded amount	The financial statement amount being tested by SAI Auditor in the specific application of substantive tests.
Regression estimate	An estimate of a population parameter for one variable that is obtained by substituting the known total for another variable into a regression equation calculated on the basis of sample values of the two variables. Ratio estimates are special kinds of regression estimates
Regularity Audit	Attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements; attestation of financial accountability of the government administration as a whole; audit of financial systems and transactions, including an evaluation of compliance with applicable statutes and regulations; audit of internal control and internal audit functions; audit of the probity and propriety of administrative decisions taken within the audited entity; and reporting of any other matters arising from or relating to the audit that the SAI considers should be disclosed.
Reimbursable activity	In intra-governmental activity, similar to goods or services, except the amounts billed to the receiving entity by the providing entity are based on some agreed-upon price, which may or may not represent market value.
Related parties	Affiliates; trusts for the benefits of employees, such as pensions, that are managed by or under trusteeship of management; management of the entity; their immediate families; and other parties the entity deals with if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the parties might be prevented from fully pursuing its own separate interests.
Remote	The chance of potential liability to the entity is slight.

Responsibility segment	In cost accounting, a significant organizational, operational, functional, or process component that has the following characteristics: (a) its manager reports to the entity's top management, (b) it is responsible for carrying out a mission, performing a line of activities or services, or producing one or a group of products, and (c) for financial reporting and cost management purposes, its resources and results of operations can be clearly distinguished, physically and operationally, from those of other entity segments.
Report	SAI Auditor's written opinion and other remarks on a set of financial statements as the result of a financial or regularity audit or SAI Auditor's findings on completion of a performance audit.
Reporting date	The date of the last day of the reporting period to which the financial statements relate
Reporting Standards	The framework for SAI Auditor to report the results of the audit, including guidance on the form and content of SAI Auditor's report.
Revenue	The gross inflow of economic benefit or service potential during the reporting period when such inflow results in increased net assets/equity other than increases relating to owners' contributions. SAI Supreme Audit Institution: Public body of a state which, however designated, constituted or organized, exercises by law, the highest public auditing function of that state. It is usually the appendage of the national legislature.
Risk	See audit risk, inherent risk, control risk, risk of material misstatement, and detection risk.
Risk of material Misstatement	SAI Auditor's combined assessment of inherent risk and the control risk. (The risk of material misstatement was formerly referred to as combined risk.)
Safeguarding controls	Internal controls to protect assets from loss from unauthorized acquisition, use, or disposition and may include controls relating to financial reporting and operations objectives.
Sample	Items selected from a population to reach a conclusion about the population as a whole. (Compare with non-representative selection).
Sampling	The application of audit procedures to fewer than all items composing a population to reach a conclusion about the entire population. SAI Auditor selects sample items in such a way that the sample and its results are expected to be representative of the population. Each item has an opportunity to be selected, and the results of the procedures performed are projected to the entire population.
Sampling Interval	An amount between two consecutive sample items in a systematic sample. The sampling interval is determined by dividing the number of items in the population by the desired number of selections. When used in the context of a systematic sample used to select items for monetary-unit sampling (MUS), it is the tolerable misstatement divided by the statistical risk factor.

Sampling Risk	The risk that SAI Auditor's conclusion based on a sample might differ from the conclusion that would be reached by applying the test in the same way to the entire population. For tests of controls, sampling risk is the risk of assessing control risk either too low or too high. For substantive testing, sampling risk is the risk of incorrect acceptance or the risk of incorrect rejection.
Sampling strata	Two or more mutually exclusive subdivisions of a population defined in such a way that each element in the population can belong to only one subdivision or stratum.
Sampling Unit	Any of the individual elements, as defined by SAI Auditor that constitute the population.
Sequential sampling	A sampling plan for which the sample is selected in several steps, with each step conditional on the results of the previous steps.
Specific control evaluation (SCE)	Evaluating the effectiveness of specific control activities in achieving the control objectives. This process is documented on the SCE worksheet.
Standard General Ledger (SGL)	A uniform chart of accounts and guidance for standardizing federal accounting. Composed of five major sections: (1) chart of accounts, (2) accounts and descriptions, (3) account transactions, (4) SGL attributes, and (5) SGL crosswalks to standard external reports.
Standard General Ledger (SGL) at the transaction Level	Implementing the SGL at the transaction level means that transactions are recorded in full compliance with the SGL Chart of Account's descriptions and posting models/attributes that demonstrate how the SGL is to be used for recording transactions of the federal government accounting process; reports produced by the systems provide financial information, whether used internally or externally, that can be traced directly to the SGL accounts; and transactions from feeder systems, which may be summarized and interfaced into the core financial system's general ledger, are posted following SGL requirements.
Statistical sampling	Audit sampling that uses the laws of probability for selecting and evaluating a sample from a population for the purpose of reaching a conclusion about the population.
Stratified random sample	A sample design by first classifying the population into several strata and then taking a random sample from each stratum.
Substantive analytical Procedures	Analytical procedures used as substantive tests.
Substantive audit assurance	SAI Auditor's judgment about the probability that all substantive tests of an assertion will detect aggregate misstatements that exceed materiality. Not the same as confidence level.

Substantive procedures or Tests	Specific procedures, including substantive analytical procedures and substantive detail tests, performed to determine whether assertions are materially misstated and to form an opinion about whether the financial statements are presented fairly in accordance with THE APPLICABLE ACCOUNTING STANDARDS.
Suitable criteria	In agreed upon procedures engagements or other attestation engagement engagements, standards for acceptability which have the attributes of objectivity, measurability, completeness, and relevance.
Supervision	An essential requirement in auditing which entails proper leadership, direction and control at all stages to ensure a competent, effective link between the activities, procedures and tests that are carried out and the aims to be achieved.
Supplemental analytical procedures	Analytical procedures to increase SAI Auditor's understanding of account balances and transactions when detail tests are used as the sole source of substantive assurance.
Systematic sampling	A method of selecting a sample in which every nth item is selected from a random start.
Test materiality	Former term, now see tolerable misstatement.
TI	Transparency International: Global civil society organization that leads the fight against corruption brings people together in a powerful worldwide coalition to end the devastating impact of corruption on men, women and children around the world. TI's mission is to create change towards a world free of corruption.
Tolerable Misstatement	The materiality SAI Auditor uses to test a specific line item, account balance or class of transactions. Tolerable misstatement is defined as the maximum error in a population that SAI Auditor is willing to accept.
Tolerable rate	The maximum population rate of deviations from a prescribed control that SAI Auditor will tolerate without modifying the planned assigned level of control risk. For tests of compliance with laws and regulations, the tolerable rate is the maximum rate of noncompliance that could exist in the population without causing SAI Auditor to believe the noncompliance rate is too high. (In statistical terms, margin or bound of error).
Transfers	Shifting of all or part of the budget authority in one appropriation or fund account to another. Entities may transfer budget authority only as specifically authorized by law. For accounting purposes, the nature of the transfer determines whether the transaction is treated as an expenditure or a non-expenditure transfer.
Treasury Financial Manual (TFM)	The Treasury Financial Manual (TFM) is Treasury's official publication for financial accounting and reporting of all receipts and disbursements of the federal government. It provides policies, procedures, and instructions for federal departments, entities, General Directorates, and other concerned parties to follow in carrying out their fiscal responsibilities.

Universe	See population.
Useful life	(of property, plant and equipment) period of time over which the entity is expected to use an asset or number of production or similar units that the entity is expected to obtain from the asset.
User controls	Controls that are performed by people interacting with IS controls. The effectiveness of user controls typically depend on the accuracy of the information produced by the IS controls.
Walk-through	Audit procedures to help SAI Auditor understand the design of controls and whether they have been implemented. They may also provide some evidence of control effectiveness. Walk-throughs of financial reporting controls include tracing one or more transactions from initiation, through all processing, to inclusion in the general ledger; observing the processing and applicable controls in operation; making inquiries of personnel applying the controls; and examining related documents.
Working papers	A record of SAI Auditor's planning: nature, timing and extent of the procedures performed; results of such procedures; and conclusions drawn from evidence obtained. Working papers may be data stored on paper, film, electronic or other media.