VOUCHING AND VERIFICATION OF ASSETS & LIABILITIES

VOUCHING

According to **R. B. Bose**, "By vouching is meant the verification of the authority and authenticity of transactions as recorded in the books of account".

In the words of **Ronald A. Irish**, "Vouching is a technical term, which refers to the inspection of documentary evidence supporting and substantiating a transaction."

De Paula writes, "Vouching means the inspection of receipts with the transactions of a business together with documentary and other evidence of sufficient validity to satisfy an auditor that such transactions are in order, have been properly authorized and are correctly recorded in the books."

According to **Joseph Lancaster,** "it is often thought that vouching consists of the mere examination of the vouchers or documentary evidence with the book entries. This is, however, quite wrong, for vouching comprises such an examination of the ledger entries as will satisfy the auditor, not only that the entry is supported by the documentary evidence but it has been properly made upon the books of accounts.

OBJECTS OF VOUCHING

1. All transactions have been recorded in the books of accounts and nothing has been left.
2. All entries recorded in the books of accounts are supported by documentary evidences which are available in the business.
3. No transaction which is not connected with the business has been recorded.
4. All transactions are properly authenticated by a responsible person.

IMPORTANCE OF VOUCHING

To assert the importance of vouching, **De Paula** has said, "vouching is the very essence of auditing, and the whole success of an audit depends upon the intelligence and thoroughness with which this part of the work is done."

The importance of vouching was also highlighted in the case of **Armitage vs Brewer and Knott (1932)**, wherein it was held that, vouching is an important part of auditor's duty and while examining any transaction vouching and routine checkup should not be ignored. If auditor shows any negligence while vouching the books of accounts, his clients can claim damages.

Vouching helps in:

1. Detect errors and frauds
2. Know the authenticity of transactions
3. Find unrecorded transactions
4. Ensures genuineness of the transactions

VOUCHERS

Voucher is known as the documentary or other evidence for the support of a transaction in the books of account.

The act of examining vouchers is defined as vouching. It is the practice followed in an audit, with the objective of establishing the authenticity of the transactions recorded in the primary books of account. It essentially consists of verifying a transaction recorded in books of accounts with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mention in the voucher has been posted to an appropriate account which would disclose the nature of the transaction on its inclusion in the final statements of account. On these considerations, the essential points to be borne in mind while examining a voucher are:[1]

1. that the date of the voucher falls within the accounting period;
2. that the voucher is made out in the client's name;
3. that the voucher is duly authorized;
4. that the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and
5. that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

Voucher can be two types:

1. **Primary Vouchers:** It is written documentary evidence available in original such as purchase order, original invoices, counterfoil of cash receipts etc.
2. **Collateral/Secondary Vouchers:** When evidence in original is not available, copies of original evidence are made available for the purpose of audit such as xerox copies of demand draft etc.

The special considerations to be borne in mind by the auditor in the course of vouching.

1. Date of the voucher.
2. Voucher is relates to business.
3. Voucher relates to the period, under audit.
4. Voucher must be in printed form.
5. Voucher is consecutively numbered and filled serially.
6. Tick and audit rubber stamp.
7. Signature of payee.
8. Amounts in words and figure.
9. Revenue stamp of one rupee, if it exceeds Rs. 500.
10. Signed and authorized by some responsible officer.
11. Comparison of evidence with accounting entries.
12. In case of alteration is made in voucher, it is properly initialed.
13. Proper filling.
14. In case of missing vouchers, reasons of their lost and duplicates copies.
15. Vouchers which have been inspected by auditor should be cancelled by stamp.
16. All vouchers relating to a particular period or particular accounts should be checked in one sitting or in a continuous process.
17. The auditor should not take the help of members of the staff of the client while vouching the entries.

VERIFICATION

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

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

OBJECTIVES OF VERIFICATION

There are number of key attributes or assertions implied in the balance, and these provide the objectives against which auditor is seeking verification. The auditor must collect evidence to satisfy six objectives. These are:[2]

1. *Completeness,* which concerns whether the account balance in the financial statements represents all of the underlying assets, liabilities, income or expense, e.g. are all the fixed assets owned by the client recorded in the financial statements?
2. *Existence,* which concerns whether the account balance represents real assets or liabilities and whether any items have been duplicated, e.g. does the account balance represent fixed assets that physically exist?
3. *Accuracy,* which refers to whether the item has been correctly recorded with respect to party, price, date, description, and quantity, e.g. looking at the underlying entries for the account, has the clerk pressed the correct buttons on the calculator or the correct keys on the keyboard, or has the depreciation charged been correctly calculated?
4. *Valuation,* which concern whether the account balance is valued at the appropriate amount, e.g. has the correct depreciation rate been used, is that rate appropriate and is the fixed asset worth the amount at which it is recorded.
5. *Ownership,* which relates to a question of title – whether the asset is the property of the company, e.g. is the fixed assets owned by the company, or is there evidence that a third party such as a leasing company has an interest, or has the company bought assets which are subject to 'reservation of title' clauses?
6. *Presentation,* which relates to the manner of presentation of an account balance in the financial statements, e.g. whether creditor have been correctly split between short and long-term creditors.

LIABILITIES OF AUDITOR AS REGARD TO VERIFICATION

"Auditor is not a valuer and cannot be expected to act as such. All that he can do is to verify the original cost price and to ascertain as far as possible that the current values are fair and reasonable and are in accordance with the accepted commercial principles." **Lansacart**

“An auditor is not liable, if in the absence of suspicious circumstances, he relies on trusted official of the company”. **In re: Kingston Cotton Mills Ltd.**

The auditor will be held liable for any loss incurred due to his being negligent in his duties. In the following judgments the auditor was held negligent.

a) If the auditor fails to verify the assets, he will be held liable as was decided in the case of ***the London Oil Storage Co. Vs. Sean Husluch & Co.(1904)***. It was held in that case that, “the auditor should verify the existence of the assets stated in the balance sheet; otherwise he will be liable for any damages suffered by the client.”
b) In the case of **Deputy Secretary Minister of Finance, Government of India vs. S.N. Dass Gupta**, it was found that on the winding up of the Aryan Bank Ltd. the auditor had not verified the cash in hand, as a result fraud was committed by management could not be found out. In this case also the judge held the auditor guilty of negligence for not verifying cash in hand and liable for any loss incurred.
c) In the case of the **Register of Companies vs. P.M. Hedge**, the auditor was held to be grossly negligent because he had not verified the cash-in-hand and balance sheet.
d) As per decision given in the **Mc Kesson and Robins** case (1939) the auditor must physically inspect some of the assets. Now the auditor has to report whether the balance sheet shows true and fair view of the state of affairs of the company. Hence, he is required to verify all the assets and liabilities appearing in the balance sheet. In case of failure, the auditor can be held liable for damages.

VERIFICATION OF ASSETS

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

According to **Joseph Lancaster** “Verification of assets is a process by which the auditor substantiates the accuracy of the right-hand side of the Balance Sheet, and must be considered as having three distinct objects : (a) the verification of the existence of assets (b) the valuation of assets and (c) the authority of their acquisition”.

The **Institute of CA of India**, sates that verification of assets should be aimed at establishing their: existence, ownership, possession, free from encumbrance, proper recording and proper verification.

GENERAL PRINCIPLES REGARDING VERIFICATION OF ASSETS

The auditor should verify the following points while conducting verification of assets (As laid down by ICAI):[3]

1. That the assets were in existence on the date of balance sheet;
2. That the assets had been acquired for the purpose of the business and under a proper authority;
3. That the right of ownership of the assets vested in or belonged to the undertaking;
4. That they are free from any lien or charge not disclose in the balance sheet;
5. That they are correctly valued having regard to their physical condition; and
6. That their values are correctly disclosed in the balance sheet.
7. Where a company or partnership has taken over the assets of a going concern, the agreement of sale should be inspected and that amount paid for them ascertained. It should be further verified that the allocation of total cost among the various assets is fair and reasonable.
8. The cost of assets acquired piecemeal should be verified with their invoices, purchase agreements, or ownership rights and the receipts of the sellers in respect of the price paid. It should be verified that expenditure on assets newly acquired and that on the renewal and replacement of old assets has been correctly recorded, consistent with the method that has been generally followed in the past.
9. When an asset is sold, its sale-proceeds should be vouched by reference to the agreement, containing the terms and conditions of sale, counterfoil of the receipt issued to the purchaser or any other evidence which may be available. If the sale of fixed assets resulted in capital profit, it should be transferred to capital reserve. However, the profit limited to original cost or a loss should be transferred to the Statement of Profit and Loss.
10. It is obligatory for a company to provide for depreciation out of the profits in accordance with provisions under sub section (1) of section 123, before any profits can be distributed

as dividend. The law requires that depreciation should be provided in the manner as specified in Schedule II of the Companies Act, 2013.

11. The existence of fixed assets, where practicable, should be verified by a physical inspection and, or by comparing the particulars of assets as are entered in the Schedule attached to Balance Sheet, with the plant or property register and reconciling their total values with the General Ledger balances.
12. Wherever possible, all the securities and document of title, cash, negotiable instruments, etc. representing the assets, should be inspected at the close of the last day of the accounting period. If this is not practicable and the examination is undertaken at the later date, a careful scrutiny of transactions subsequent to the date of the balance sheet must be made to ensure that the changes in their balance that have subsequently taken place and are supported by adequate evidence.
13. It should be ascertained that no unauthorized charge has been created against an assets and all the charges are duly registered and disclosed. Where shares or securities are lodged with a bank to secure a loan or an overdraft, a certificate should be obtained from the bank showing the nature of the charge, if any.
14. Where assets, e.g., government securities, share scrips and debenture bonds are in the custody of a third party other than bank, they must be inspected.
15. Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, should be disclosed separately.

VERIFICATION OF LIABILITIES

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

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

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

1. To verify the existence of liabilities shown in balance sheet and liabilities shown in the balance sheet have arisen out of business operation.
2. To verify that liabilities as shown in the balance sheet are actually payable.
3. To verify the correct value of such liabilities.
4. To verify that all existing liabilities are actually included in the account and doubtful liabilities should not be included in the actual liabilities.
5. To verify the adequacy of disclosure.

Verification of liabilities may be carried out by employing following procedures:[4]

1. Examination of records;
2. Direct confirmation procedures;
3. Examination of disclosures;
4. Analytical review procedures;
5. Obtaining management representation.

GENERAL PRINCIPLES REGARDING VERIFICATION OF LIABILITIES

It is not possible to detail the procedures for verifying all possible liabilities. However some general principles can be discerned and these should be applied according to the particular set of circumstances met with in practice in an examination. These are:[5]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

r) **Risk:** Assess the risk of misstatement.

Review Questions

1. What is vouching? "Vouching is the essence of auditing". Comment.
2. What special points should an auditor pay attention while examining vouchers?
3. "Vouching is the backbone of auditing". Discuss the object of vouching.
4. Define the term verification. What are the objectives of verification?
5. What do you mean by 'Verification'? As an auditor, what precautions would you take into consideration while conducting verification of assets?
6. "An auditor is not valuer and yet he is intimately concerned with proper valuation of assets and liabilities." Discuss the above statement quoting some legal decisions in this respect.
7. Explain verification of liabilities. What are the general principles regarding verification of liabilities?

End Notes

[1] http://www.icaiknowledgegateway.org/littledms/folder1/chapter-5-vouching-control.pdf
[2] Michael Sherer, Stuart Turley, Current Issues in Auditing, SAGE Publications, 28 May, 1997.
[3] General Principles Regarding Verification of Assets, Verification of Assets and Liabilities, ICAI.

[4] Ibid.
[5] A.H. Millichamps, Auditing, Thomson, 8th edition.