CHAPTER SIX
AUDIT APPROACH IN RELATION TO LIABILITY AND CAPITAL ACCOUNTS

6.1.1 Audit Approach in Relation to Loans and Advance

- Examine the policy of the company concerning loans and advances.
- Obtain confirmation from concerned party.
- Examining documents (transactions and recording) and comparing with balance.
- Verifying disclosure of loans and advances on the

6.1.2 Audit Approach in Relation to Payables

- Examining the effectiveness of the internal control system of the business organization over payable.

Internal control designed over payable considered as effective when the following over payable fulfilled.

- Separation of duties (like approvals of vendors invoice, recording of payables, preparation of checks, and control over checks already prepared).
- Ascertaining proper authorization for creation of liability.
- Ensuring that unauthorized liabilities are not recorded and paid.

- Designing case in which there is proper authorization exist for liability liquidation.
- Obtaining schedules of payables with appropriate age analysis and checking with control account.
- Review the year end cut-off procedures for purchase (if payable occurred from purchase).

- Reviewing the individual account balance. In reviewing the individual account balance consider;
  - Is the balance made up of specific item outstanding within a reasonable period?
  - Have all items been authorized for payment?
  - Does the amount agree with the supplier’s statement?
  - Is confirming for account balance

6.1.4 Audit Procedures for Accrued Charges and Advance Revenue Collection

- Reviewing the clients system for handling accruals and advance.
- Obtaining schedules of accruals and advance and performing analytical procedures.
- Testing a sample of accruals and advance for correct calculation.
- Obtaining confirmation for completeness.

6.1.5 Audit Procedures in Relation to Long-term Payable

- Long term payable includes loans and payables paid in long term period, pension, sinking fund, bonds, etc.
- Check the authority to acquire such debt/loan from either board of director or annual general meeting minutes and determine:

✓ The amount of loan

✓ Interest payable on loan

✓ Repayment of principal and interest.

- Check the articles/memorandum of association (by-law or rules) to ensure the client has power to raise the amount of loan raised.
- Obtain the loan agreement and check for;

✓Amount of the loan

✓Nature of the loan

✓Interest payable

✓Repayment of the loan.

- Agree these details with the details obtained with client own record.

❖Obtain schedules of loans outstanding at the balance sheet date, indicating the name of the ledger, amount of interest, date of maturity and any security pledged. Compare the operating balance with last year's working papers.

❖Communicate directly with lenders and request for confirmation of amount outstanding, interest due and repayment pattern.

- ❖Checks the security pledged and ensure that it adequately cover the loans.
- ❖Ascertain/verify interest charges for the period by computing such interest
- ❖If the loan had been obtained for specific purpose, ascertain whether it was used for that purpose by verifying the assets acquired there from and the value of the physical asset as well the value of the loan.
- Examining **proper classification** and **disclosure** in financial statement in accordance with generally accepted accounting principles.

6.1.6. Audit procedure in Relation to Contingent liability

- Contingent liability is the possible future direct obligation.
- It is the result of **past act or possible future acts**.
- As of balance sheet date, there is no actual liability of determinable amount.
- However, the future financial condition of the company may be seriously affected by it.

Example of contingent liability includes the following:

- Additional income statement assessment
- Lawsuit
- Breach of contract
- Product guarantees
- Guarantees of other obligation, etc

It is difficult to determine contingencies; because evidence of their existence may not appear in the accounting or other record. Audit procedures for contingency include the following:

- Examining purchase and sales contract, lease agreement, correspondence, etc.
- Examining the minutes of meeting of directors and other committees.
- Examining the disclosure on the financial statement

6.2 Audit approach in relation to capital accounts

6.2.1. Audit Procedures for Share Capital Account

- Verify the opening balance with references to the preceding year's closing balance which should be equal to the current year's balance except for addition.
- Verify the existing share capital with reference to the shareholders register and the ledger.

- Check for any transfers made and ensure that they were made by independent party.
- Communicate with third parties to such transfer.
- Obtain authority for the issue of the share with reference to the annual general meeting minutes.

- Obtain the articles/memorandum of association and check for a;
  - Authorized share capital
  - Mode of issuing the share
  - Types of shares allowed to be issued

- If there is any change in the articles/memorandum of association, such change agreed to a resolution by the annual general meeting and approved by competent court and allowed by the registrar of companies permitting the client to increase share capital.
- Obtain letter of allotment and compute the amount received in respect of the shares ensure that the allotment approved by the board of director.
- Cross-check the information in the

- Agree proposed dividend/paid dividend to the minute of board of directors.
- Confirm the dividend payments are in *agreement with the issued share capital* of the client.
- For shares issued at premium, check the movement of reserves and supporting authority.

❖Ensure that the **proceeds of the sale of share** are traced to the **cash journal and bank account**.

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THANK YOU VERY MUCH!!!