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GUIDANCE NOTE ON AUDIT OF CASH AND BANK BALANCES*

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Audit of Cash and Bank Balances

The following is the text of the Guidance Note on Audit of Cash and Bank Balances issued by the Auditing Practices Committee (APC)** of the Council of the Institute of Chartered Accountants of India. This Guidance Note should be read in conjunction with the Statements on Standard Auditing Practices (SAPs)+ issued by the Institute.

1. Para 2.1 of the *Preface to the Statements on Standard Auditing Practices*, issued by the Institute of Chartered Accountants of India, states that the "main function of the APC is to review the existing auditing practices in India and to develop Statements on Standard Auditing Practices (SAPs) so that these may be issued by the Council of the Institute." Para 2.4 of the Preface states that the "APC will issue Guidance Notes on the issues arising from the SAPs wherever necessary."

2. The Auditing Practices Committee has also taken up the task of reviewing the Statements on auditing matters issued prior to the formation of the Committee. It is intended to issue, in due course of time, SAPs or Guidance Notes, as appropriate, on the matters covered by such Statements which would then stand withdrawn. With the issuance of this Guidance Note on Audit of Cash and Bank Balances, Chapter 6 of the *Statement on Auditing Practices*, titled 'Cash and Bank Balances', shall stand withdrawn.¹ In due course of time, the entire *Statement on Auditing Practices* shall be withdrawn.

Introduction

3. Cash and bank balances may constitute a significant proportion of the total assets of an entity. An important feature of cash and bank balances which has a significant impact on the related audit procedures is that these assets are highly prone to misappropriation, misapplication and other forms of fraud.

4. In any auditing situation, the auditor employs appropriate procedures to obtain reasonable assurance about various assertions (see Statement on Standard Auditing Practices 5, *Audit Evidence*). In carrying out an audit of cash and bank balances, the auditor is particularly concerned with obtaining sufficient appropriate audit evidence to corroborate the management's

** Now known as the Auditing and Assurance Standards Board (AASB).

+ Now known as the Auditing and Assurance Standards (AASs).

¹ The special aspects of audit of cash and bank balances in the case of banks are dealt with in the Guidance Note on Audit of Banks (edn. 2001).

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assertions regarding the following:

- Existence - that recorded cash and bank balances exist as at the year-end.
- Rights and obligations - that recorded cash and bank balances represent the assets of the entity.
- Completeness - that there are no unrecorded cash and bank balances.

Besides the above, in certain situations, the auditor may also be particularly concerned with the valuation of cash and bank balances, e.g., in the case of foreign currency held by the entity or in the case of bank accounts designated in foreign currencies.

Internal Control Evaluation

5. The auditor should study and evaluate the system of internal control relating to cash and bank balances to determine the nature, timing and extent of his other audit procedures. He should particularly review the following aspects of internal control relating to cash and bank balances.²

- (a) segregation of duties relating to authorisation of transactions, handling of cash/issuance of cheques and writing of books of account, and rotation of the duties periodically;
- (b) proper authorisation of cash and banking transactions;
- (c) daily recording of cash transactions;
- (d) safeguards such as restrictive crossing of cheques, use of pre-printed, pre-numbered forms;
- (e) periodic reconciliation of bank balances;
- (f) reconciliation of cash-on-hand with book balance on a daily basis or at other appropriate intervals, including surprise checks by higher authorities;
- (g) safe custody of cash, cheque books, receipt books etc.; and
- (h) cash/fidelity insurance.

² The extent of review of controls would depend upon the facts and circumstances of each case. Reference may be made in this regard to the *Internal Control Questionnaire*, issued by the Institute of Chartered Accountants of India in 1976 which contains, *inter alia*, an illustrative list of internal controls in relation to cash and bank balances.

Verification

6. Verification of cash and bank balances may be carried out by employing the procedures described in paragraphs 7-27. It may, however, be emphasised that the nature, timing and extent of substantive procedures to be performed is a matter of professional judgement of the auditor which is based, *inter alia*, on the auditor's evaluation of the effectiveness of the related internal controls.

Verification of Cash Balances

7. The auditor should carry out physical verification of cash at the date of the balance sheet. However, if this is not feasible, physical verification may be carried out, on a surprise basis, at any time shortly before or after the date of the balance sheet. In the latter case, the auditor should examine whether the cash balance shown in the financial statements reconciles with the results of the physical verification after taking into account the cash receipts and cash payments between the date of the physical verification and the date of the balance sheet. Besides physical verification at or around the date of the balance sheet, the auditor should also carry out surprise verification of cash during the year.

8. All cash balances in the same location should be verified simultaneously. Where petty cash is maintained by one or more officials, the auditor should advise the entity to require the officials concerned to deposit the entire petty cash on hand on the last day with the cashier. The auditor should enquire whether the cashier also handles cash of sister concerns, staff societies, etc. In such a case, cash pertaining to them should also be verified at the same time so as to avoid chances of cash balances of one entity being presented as those of another.

9. If IOUs ('I owe you') or other similar documents are found during physical verification, the auditor should obtain explanations from a senior official of the entity as to the reasons for such IOUs/other similar documents remaining pending. It should also be ensured that such IOUs/other similar documents are not shown as cash-on-hand.

10. The quantum of torn or mutilated currency notes should be examined in the context of the size and nature of business of the entity. The auditor should also examine whether such currency notes are exchanged within a reasonable time.

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11. If, during the course of the audit, it comes to the attention of the auditor that the entity is consistently maintaining an unduly large balance of cash-on-hand, he should carry out surprise verification of cash more frequently to ascertain whether the actual cash-on-hand agrees with the balances as shown by the books. If the cash-on-hand is not in agreement with the balance as shown in the books, he should seek explanations from a senior official of the entity. In case any material difference is not satisfactorily explained, the auditor should state this fact appropriately in his audit report. In any case, he should satisfy himself regarding the necessity for such large balances having regard to the normal working requirements of the entity. The entity may also be advised to deposit the whole or the major part of the cash balance in the bank at reasonable intervals.

12. Where postdated cheques are on hand on the balance sheet date, the auditor should verify that they have not been accounted for as collections during the period under audit.

Verification of Bank Balances

13. The auditor should advise the entity to send a letter to all its bankers to, directly confirm the balances to the auditor. The Appendix to this Guidance Note gives an illustrative proforma letter of request for confirmation to be used for this purpose. The request for confirmation should also cover dormant accounts as well as accounts closed during the year.

14. The auditor should examine the bank reconciliation statement prepared as on the last day of the year. He may also examine the reconciliation statements as at other dates during the year. It should be examined whether (i) cheques issued by the entity but not presented for payment, and (ii) cheques deposited for collection by the entity but not credited in the bank account, have been duly debited/credited in the subsequent period. For this purpose, the bank statements of the relevant period should be examined. If the cheques issued before the end of the year have not been presented within a reasonable time, it is possible that the entity might have prepared the cheques before the end of the year but not delivered them to the parties concerned. In such a case, the auditor should examine that the entity has reversed the relevant entries.

15. Where the auditor finds that post-dated cheques are issued by the entity, he should verify that any cheques pertaining to the subsequent period have

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not been accounted for as payments during the period under audit.

16. The auditor should pay special attention to those items in the reconciliation statements which are outstanding for an unduly long period. The auditor should ascertain the reasons for such outstanding items from the management. He should also examine whether any such items require an adjustment/write-off.

17. The auditor should be alert to the possibility that even though the balance in an apparently inoperative account may have remained stagnant, transactions may have taken place in that account during the year.

18. Where a large number of cheques has been issued/deposited in the last few days of the year, and a sizeable proportion of such cheques has subsequently remained unpaid/uncleared, this may indicate an intention of understating creditors/debtors or understating/overstating bank balances. In such a case, it may be appropriate for the auditor to obtain confirmations from the parties concerned, especially in respect of cheques involving large amounts. The auditor should also examine whether a reversal of the relevant entries would be appropriate under the circumstances.

19. The procedures discussed in paragraph 18 should also be considered by the auditor in cases where a large number of cheques is on hand at the date of the balance sheet and a sizable proportion of such cheques has subsequently remained undeposited/uncleared.

20. In relation to balances/deposits with specific charge on them, or those held under the requirements of any law, the auditor should examine that suitable disclosures are made in the financial statements.

21. In respect of fixed deposits or any other type of deposits with banks, the relevant receipts/certificates, duly supported by bank advices, should be examined.

22. Remittances shown as being in transit should be examined with reference to their credit in the bank in the subsequent period. Where the auditor finds that such remittances have not been credited in the subsequent period, he should ascertain the reasons for the same. He should also examine whether the entity has reversed the relevant entries in appropriate cases.

23. The auditor should examine that suitable adjustments are made in respect of cheques which have become stale as at the close of the year.

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24. Where material amounts are held in bank accounts which are blocked, e.g., in foreign banks with exchange control restrictions or any banks which are under moratorium or liquidation, the auditor should examine whether the relevant facts have been suitably disclosed in the financial statements. He should also examine whether suitable adjustments on this account have been made in the financial statements in appropriate cases.

25. Where the auditor finds that the number of bank accounts maintained by the entity is disproportionately large in relation to its size, the auditor should exercise greater care in satisfying himself about the genuineness of banking transactions and balances.

Examination of Valuation and Disclosure

26. The auditor should satisfy himself that cash and bank balances have been valued and disclosed in the financial statements in accordance with recognised accounting policies and practices and relevant statutory requirements, if any.³ In this regard, the auditor should examine that following items are not included in cash and bank balances:

- (a) Temporary advances.
- (b) Stale or dishonoured cheques.

Postage and revenue stamps, if material in amount, may be shown separately instead of being included under cash and bank balances.

27. The auditor should also examine that suitable disclosures as mentioned in paragraphs 20 and 24 above are made in relevant cases.

³ For valuation of foreign currency held as cash-in-hand and bank balances designated in foreign currencies, reference may be made to Accounting Standard 11, Accounting for the Effects of Changes in Foreign Exchange Rates, issued by the Institute of Chartered Accountants of India.

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Appendix

Illustrative Letter of Confirmation – Bank Balances

(Ref. Paragraph 13)

[Letterhead of Entity]

[Name and Address of Bank]

[Date]

Dear Sirs,

Please send directly to our auditors (name and address of the auditors) details of balances as at the close of business on [date] of all our accounts with you as well as details of charges held against such balances, with a copy to us. For your convenience, we enclose in duplicate a form in which details of our balances with you can be filled in. If you find the spaces on the form insufficient to contain all the relevant information, please attach a separate statement.

Please note that this request covers all our accounts with you as at the above-mentioned date, including any dormant accounts. We would also request you to give particulars of any of our accounts closed during the year. We would request you to state "Nil", wherever applicable.

Yours faithfully,

(Signature of person authorised to operate accounts)

**Reply from
(Bank)**

[Name and Address of Auditors]

Dear Sirs,

Date: _____

Re : (Name of Client)

At the request of our clients, we submit below particulars of their accounts, Investments, bills, etc., as at the close of business on as shown by our records.

1. *Current Accounts in Credit*

| Designation of Account | Amount |
|------------------------|--------|
|------------------------|--------|

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2. *Overdrawn Current Accounts, Overdraft Accounts or Cash Credit Accounts.*

| | | |
|------------------------|--------|---|
| Designation of Account | Amount | Security held (give brief description. In the case of securities please list fully) |
|------------------------|--------|---|

3. *Loan Accounts*

| | | |
|------------------------|--------|---|
| Designation of Account | Amount | Security held (give brief description. In the case of securities please list fully) |
|------------------------|--------|---|

4. *Fixed, Call and Short Deposit Accounts*

| | | | |
|--------|--------------------------------------|----------|-------------------------------------|
| Amount | Interest Accrued to the closing date | Due Date | Particulars of any charges of liens |
|--------|--------------------------------------|----------|-------------------------------------|

5. *Investments and Other Documents of Title Held in Safe Custody*

| | |
|--------------|--------------------------------------|
| Designation. | Face value or number of shares held. |
|--------------|--------------------------------------|

6. *Margin against letters of credit Guarantees issued, etc.*

| | |
|------------------------|--------|
| Designation of Account | Amount |
|------------------------|--------|

7. *Bills for Collection*

| | | |
|------------------------|--------|----------|
| Designation of Account | Amount | Due date |
|------------------------|--------|----------|

8. *Bills Discounted or Purchased.*

| | | |
|----------------|--------|----------|
| Name of Drawee | Amount | Due date |
|----------------|--------|----------|

9. *Letters of Credit Open and Outstanding*

| | | |
|--------------|---------------------|------------|
| In favour of | Amount not utilised | Valid upto |
|--------------|---------------------|------------|

10. *Guarantees given on behalf of clients*

| | | |
|--------------|---------|----------------|
| In favour of | Amount. | Date of expiry |
|--------------|---------|----------------|

We certify that the above particulars are full and correct and do not exclude any other obligations of the entity to us.

Yours faithfully,

Name of Bank
Designation of Signatory