

## QUESTION NO. 1

**ADVANTAGES OF AN AUDIT**

Audit has given many advantages to different classes of society. Some of these are listed below:

**(a) BUSINESS:****(1) Expression of Opinion:**

International Standard on Auditing, objective and General Principles Governing an Audit state that the objective of an audit is to enable the auditor to give independent opinion on financial statement.

**(2) Detection and Prevention of Errors:**

The errors whether committed innocently or deliberately are discovered by audit and its presence prevents their occurrence in future. Thus they can be rectified & prevented.

**(3) Detection and Prevention of Frauds:**

Just like errors, the frauds are discovered by audit and its presence provides a moral check on the staff and thus their future possibility is minimized if not eliminated.

**(4) Moral Check:**

An audit always has a moral check on management and employees. When they know their work is going to be audited by an independent person they shall be more careful and less prone towards fraudulent activities.

**(5) Market Creditability:**

Usually the banks and credit institutions require the copy of audited accounts and auditor's report to estimate the ability of borrower to repay the loans. Therefore, a client having a good report can easily get loan from bank and other agencies.

**(6) Business Acquisitions:**

In case of mergers or amalgamation, the accounts are of extreme value to the concerned parties to have correct estimate of the worth of the business.

**(7) Claims for Compensations:**

In the presence of audited accounts. Various claims like fire insurance can easily be settled down.

**(8) Shareholder's Satisfaction:**

According to the stewardship concept, the shareholders (owners) would like to see the performance result of managers. To have assurance of the fair representation of accounts, they would like to get the accounts audited.

**(9) Weakness in Systems:**

At the end of the audit, usually the auditors report all the weaknesses through a letter, that they come across in the course of their work. Such a letter is called Management Letter or Letter of Weakness. Management can improve its procedures in the light of this letter.

**(10) Check on Directors:**

Audit acts as a check upon the directors and a precaution against fraud on the part of the management.

**(11) Valuable Advice:**

The auditor has expert knowledge about the accounts and financial problems, so he may be consulted about these problems.

**(12) Correct Information about Business:**

Due to the fear of audit, the work of accounting always remains upto date and correct information is given to the members in time.

**(B) TO PUBLIC:****(13) Satisfaction about Business Operation:**

The public in general, in the presence of audit, receives reliable statements of accounts indicating the true financial picture of the concern and they can fetch results from it and feel satisfaction about it.

**(14) Safety from Exploitation:**

The interest of the public and shareholders is safeguarded in the presence of audit otherwise the management may have exploited them. Actually this is the main reason for which the audit has been made compulsory in the public limited companies.

**(15) Facility for Prospective Investor:**

The prospective investor can easily judge the position of the company and thus make the decision to invest in one company, and not in the others. Similarly, the outsiders like bank and tax authorities etc. will rely upon the business accounts if these are audited, otherwise not.

**(C) TO GOVERNMENT:****(16) Easy assessment and Recovery of Taxes:**

In the presence of audited accounts the tax authorities can easily assess and recover the income tax.

**(17) Checking Excise duty evasion:**

The audited accounts will help in checking the evasion of excise duty etc.

**(18) Foreign Aid:**

Foreign agencies prefer to those businesses whose accounts are audited.

**(19) Checking Economic Progress:**

The government can check the economic progress of various companies by going through the audited accounts and thus can know the overall economic position of a particular kind of business in the country and can take proper action for that.

**(20) Leading to Economic Progress:**

The joint stock companies have played a major role in boosting up the economic progress of a country in the modern age. The successful operation of the companies would have not been possible without the presence of audit, thus audit leads to Economic Progress.

**(21) Privatization:**

If nationalized industries are running in loss constantly, the government may denationalize them after going through the audited accounts of these industries.

**(22) Proper Supervision:**

Where the proprietor of a business concern cannot personally supervise his affairs, the audit acts as a check on the working of the employers and the losses caused by defalcation are avoided.

**QUESTION NO. 2****INTERNAL CHECK:**

It is a system whereby the duties of recording the business transactions are allocated in such a manner that another person checks work done by one person automatically.

**Example:**

For example, a bill is prepared by an accountant, is checked by his department incharge and, after the approval of the chief accountant, is sent to the Cashier for making payment.

**PRINCIPLES INTERNAL CHECK**

For an ideal and non-fraudulent internal control system, the following principles of internal check can be applied.

- (1) Administrative
- (2) Financial

**[ADMINISTRATIVE]****(1) Clear Cut Duties:**

Division of duties is a part of internal control. The duties should be assigned according to the capacity. One person should perform only one duty, which should be clear-cut, e.g., one person records sales while other keeps cash books.

**(2) No Complete Reliance:**

The business rules of regulations should be equal for all employees. No exemptions should be given to any individual. The business authorities should not rely on any person completely.

**(3) Sufficient Staff:**

The staff should be sufficient according to the requirements of business.

**(4) Rotation of Duties:**

The duties of clerks should be changed from time to time and from departments to departments or branch wise, after a fixed period.

**(5) Safety Measures:**

According to the business requirements different safety measures should be undertaken.

**(6) Cash and Personal Security:**

A reasonable cash security and personal guarantee should be taken at the start of the employment.

**(7) Correspondence Received:**

All daily correspondence received should be recorded by a junior person and taken to the officer's room where opened and presented for making.

**(8) Physical Check of Stock:**

The stock should be confirmed by the purchase manager surprisingly.

**(9) Quotation System:**

Open choice quotation system through print media should be followed.

**(10) Attendance Procedure:**

The attendance procedure should applied equally on juniors and seniors.

**[FINANCIAL]**

**(11) Double Entry System:**

Real double entry system of recording, debit by one person and credit effect by another should be followed.

**(12) Use of Accounting Calculator:**

If the business resources allow then calculators, computers and printers should be used for computations.

**(13) Internal Audit:**

There should be a separate department according to business needs for overall checking.

**(14) Remittance and Deposit:**

All the remittance received should be deposited in the bank account the same day or next day if received after the close of banking hours.

**(15) Payment Authorization:**

Every payment bill should be first approved by the chief accountant.

**(16) Wages and Salaries:**

Salaries should be paid through crossed cheques as there are no chance of fraud in it but wages in indirect manner through token slips avoiding direct payment by the job incharge.

**(17) Records of Goods:**

Detailed records should be maintained for all goods received and sent out.

**(18) Receipt Books:**

The receipts books used should be

- Printed
- Numbered consecutively
- Having a carbon copy

**(19) Petty Cash Fund:**

A separate fund for various minor expenditures should be established on imprest system.

**(20) Review of Work Done:**

A system should be maintained under which work done by the individuals may be seen by the senior officers.

**(21) No Access to Books / Accounts:**

The cashier should not be allowed to record or inspect customer's account.

**(22) Separation of Records:**

Financial and accounting operations must be separated.

**(23) Statement of Accounts:**

All customers should be informed about the summary of their dealing after the end of every quarter.

**(24) Internal Appliance Computer and Other Machine:**

Modern mechanical appliance such as cash, registers, receipt books, accounting machines should be used in the business.

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**QUESTION NO. 3**

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**CONTINUOUS AUDIT:**

As it is apparent from its name, a continuous audit is that which is performed in a regular manner during the whole period or at different intervals in a period. In a continuous audit the auditor's staff attends the client location for the whole time or at frequent intervals and examines the work as it is done.

**Definition:**

*"Such examination whereby accounting records of a business for a particular financial year is examined during the same year with some intervals as this audit is conducted throughout the year, it is called continuous or running audit."*

**Explanation:**

As it is apparent from its name, a continuous audit is that which is performed in a regular manner during the whole year at different intervals in a year. It is a detailed audit and involves exhaustive examination of accounting records.

## ADVANTAGES OF CONTINUOUS AUDIT

### (1) Detailed Checking:

The greatest advantage of detailed audit is reduction in audit risk as hundred percent of records are checked. No other audit facilitates a detailed checking than as much as possible, in this type of audit.

### (2) Nip the Evil in Bud:

As books are checked soon after the entries have been made, so errors can be spotlighted as well as rectified very early and quickly. Similarly a fraud can be detected at early stage.

### (3) Moral Check on Fraud:

Due to uncertain and frequent visits, moral check involved is considerably strengthened. So it is a continuous hindrance for the series of frauds.

### (4) Quick Presentation of Audited Accounts:

As most of checking has already been performed during the course of year, the final audited accounts can be presented to share holders, at AGM, soon after the closing of financial year.

### (5) Low Work Load:

An auditor has ample time before finalization of accounts, so, due to low workload, greater attention can be paid to checking of accounts and detecting and preventing errors.

### (6) Interim Dividend and Bonus:

Where the directors of a company intend to declare an interim dividend, continuous audit will help in preparation of interim accounts without much effort.

### (7) Less Chances of Over Looking Important Points:

The continuous audit keeps the auditor in constant touch with various aspects of business and projects undertaken. He has better knowledge of what is going on. So he is not likely to over look important financial information.

### (8) Strategic Audit Plan:

The auditor should change his audit plan according to change in circumstances. This is best achieved in a continuous audit.

### (9) Learning for Audit Staff:

In a continuous audit the control system is analyzed in detail. Audit work is also carried out in detail. So continuous audit provides an excellent learning opportunity for junior level audit staff.

### (10) Encourage Investment:

It encourage investment by presenting ready audited information to decision makers in the absence of this audit annual reports are presented when real need of this annual report has become lapsed.

(11) **Valuable Suggestions:**

Since auditor remains more in touch with the business, he is in a position to give valuable suggestions to his clients.

(12) **Proper Management of Work:**

Continuous audit is mostly carried out where the volume of work is very large. Therefore, the auditor can manage his work properly by checking the transactions continuously.

(13) **Up to Date Record:**

As employees will have to be more efficient for presenting up-to-date record to the auditors, so this helps to maintain up-to-date books.

(14) **Easy Settlement of Business Purchase Price:**

It is easy to settle the business purchase price, as net worth (assets minus liabilities) will be acceptable to both seller & buyer.

(15) **Easy Settlement of Insurance Claim:**

It is helpful in settlement of insurance claim, as net loss will be supported by auditor's report.

(16) **Avoidance of Penalties:**

Laws like Companies Ordinance and Income Tax Ordinance prescribe certain penalties for any non-compliance with these laws. As such non-compliance is located at very early stage due to continuous audit, so the management can avoid the penalties by complying with laws.

### DISADVANTAGES OF CONTINUOUS AUDIT

(1) **Alteration in Figures:**

It is possible that the figures can be altered either innocently or fraudulently, after the auditor has checked them.

(2) **Thread of Work is Lost:**

The audit, not being carried on consecutively till it finishes, it may be possible for audit clerk to lose the thread of work and omit to follow up those transaction which were left open by him at the date of last visit.

(3) **Not Fit for Small Business:**

It is not suitable for small business concern. A small business has only a few transactions so there is no need of extra audit. Owners or managers can know facts behind the books & a detailed audit is just a burden.

(4) **Expensive:**

It is more expensive as more time is spent in this type of audit by the auditors in examining the business accounts.

(5) **Staff Intimacy:**

The accounting staff and the audit staff work side by side, and friendly relationship and sympathetic view of audit staff may fail to show the true and fair position of accounts.

**(6) Inconvenient for Staff:**

The employees, in recording the transactions in the auditor's presence, face inconvenience because both the parties need the books.

**(7) Mechanical Nature of Work:**

As the audit work is performed for major time period, the audit staff may take it mechanically. The audit staff may only check routine items and may not pay attention on overall financial statements.

**(8) Seasonal Industries:**

Continuous audit cannot be conducted for seasonal industries like textile & sugar. These entities operates in a particular period and no significant activity is taken during the off-season. The volume of work is reduced in that period and need for continuous audit does not arise.

**QUESTION NO. 4****(a) CASH SALES****Supporting Evidences:**

- ⇒ Carbon copies of cash memos/ sales invoices/sold notes (four copies).
- ⇒ Sales manual for discount policy.

**Mechanism:**

Auditor should take care of all the memos held by all the parties rather checking one or two memos. If the auditor does not do so, he will be held liable for any fraud, which remained undetected as decided in the case of Pendlebuy's Ltd Vs Ellis, Green and Co. (1936).

Chronological order of memos is must of memos are kept in files haphazardly it is a sure sign of missing some vouchers. Cancelled cash memos cannot be separated on the grounds that it has no concern with records. Even cancelled memos should be filled up because auditor may demand even evidences of those transactions which were mutually barred.

Distinction should be made between cash discounts and trade discounts because trade discounts should be entered in books at net value of sales. Sales manual should be verify carefully viewed to see the discount policy of organization.

**(b) WAGES AND SALARIES****PAYMENT OF WAGES:****Supporting Evidences:**

- ⇒ Wages sheet.
- ⇒ Job cards / identity cards.
- ⇒ Leave register.
- ⇒ Files of personal department.
- ⇒ Employees state insurance cards / provident fund deduction sheet.

**Mechanism:**

Checking of internal control: In the vouching of wages, internal control and internal check system must be carefully viewed and according to degree of efficiency. Vouching should be performed if system is quite adequate then test check may be applied by reviewing payments to few workers.

Checking of wages sheet: "Padding is a way of including names of ex-employees in wages sheet to show more payments. Auditor should test check names of some workers in job cards and in forman's register so that no "dummy" worker is shown in wages sheet.

Auditor should see that responsible official properly signs payments of wages before the preparation of wages sheet.

He should also examine the totals, deductions and net amounts. Amount carried forward and brought forward should be vouched in wages sheet. So casting of wages sheet is a must.

To check number of workers on different jobs, auditor can review files of personal department. If strength of workers is more than what is shown in books. It indicates the presence of "ghost workers".

Employees insurance card or provident fund statement is good voucher to check payments shown in wages sheet because any payment to dummy workers will be in wages sheet without any effect in insurance or provident fund records.

Sometimes workers are employed causally due to seasonal requirement or due to extra work load (daily wages) these workers should be paid separately.

Auditor should tally total wages paid with estimate of costing department (on the basis of previous months wages sheet) and any abnormal difference should be pin pointed to responsible authority.

He should see that the name of same person is not appearing again and again that may lead to misappropriation.

Workers on leave: Leave register should be examined to see the names of workers on leave without pay. Names in that register should be absent from wages sheet.

Surprise visit: Surprise visit on the date of payment may also be fruitful, although it is not his duty get this will ensure that payment is made to only those workers who show their job cards or identity cards.

Additional workers: Auditor should check the strength of each department and compare with sanctioned strength if workers are more. Then inquiry should be made for additional workers employed.

**PAYMENT OF SALARIES:****Supporting Evidences:**

- ↳ Salaries book cheques drawn.
- ↳ Letter of appointment.
- ↳ Minutes of directors meeting.
- ↳ Annual returns of income tax / tax deduction certificate.

**Mechanism:**

First the auditor should inspect internal check system as in the case of wages because in sequence salaries payment automatically passes from many hands so maximum chances of correct amount transferred to Cash Book is possible.

While checking the entry with the voucher, he should see that the gross salary is entered on the payment side and all the deduction are entered on the payment side and all the deductions are entered on the receipts side in the corresponding cash column.

Auditor can vouch salaries paid by comparing a month's salaries book and from cheques drawn in favour of permanent employees.

Sometimes increment is awarded to employees according to the terms of appointment so letter of appointments are as per agreement or as per resolutions passed at the meeting of the board of directors or the shareholders. The auditor should verify agreements and resolutions to see that the payments are in order.

On salary, tax is deducted at source so amount of salary can be confirmed from tax deduction certificate issued to employee for tax withholdings from employee by company for tax department.

He should see that provident fund and insurance deductions are already made to arrive at net salary (for which cheques will be issued).

**(c) DIVIDEND INCOME****Supporting Evidences:**

- ⇒ Counterfoil of dividend warrants.
- ⇒ Letter covering the check.
- ⇒ Tax deduction certificate.

**Mechanism:**

Auditor should carefully see the dividend amount in comparison of amount on counterfoils (detached from dividend warrants). Letter covering the check is also a source of confirming amount.

On amount of dividend, withholding tax is deducted on behalf of the tax department. Exact amount of dividend can also be vouched through tax deduction certificate Broker's record can be helpful while inspecting to see either investment was sold at ex-dividend or cum-dividend.

**(d) TRAVELING EXPENSES****Supporting Evidences:**

- ⇒ Manuals containing rules.
- ⇒ Receipt from traveling agency.
- ⇒ Minutes of board's meeting.

**Mechanism:**

In efficient internal control system manuals are maintained by every organization stating clear rules and regulations including policy for traveling expenses so manuals should thoroughly be read.

All the payments vouchers regarding traveling must be supported by receipts received from traveling agency.

If any amount is reimbursed that must be taken care and be deducted from traveling allowance.

Whenever there is an extra ordinary type of traveling, a responsible person should authorize. The voucher Director's traveling expense: Minutes of directors meeting decide that to what extent director can spend for traveling so these should be vouched. If traveling is for attending board's meeting then attendance register can confirm these expenses paid.

The auditor should see the resolution also, fixing the traveling expenses of the directors per meeting. Generally traveling expenses are given to such director as normally stay at a place which is not the place of the meeting.

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### QUESTION NO. 5

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#### (a) FURNITURE AND FIXTURE

The auditor must consider the following points while verifying furniture and fittings:

- (a) The auditor should verify furniture and fittings with the relevant register and various invoices.
- (b) The auditor must examine the items of furniture purchased during a certain period under audit by physical inspection.
- (c) The auditor must check that depreciation has been properly charged in this context. In addition to this he must also see that the net figures of furniture after depreciation is shown in the balance sheet.
- (d) The auditor must see that my expenses incurred in context to purchase of these items should be capitalized.

#### (b) TRADE MARKS

See Paper 2017 Question No. 5 (d)

#### (c) BILLS RECEIVABLE

An auditor must keep in mind the following points while verifying bills receivable.

- (a) The auditor should ask for a certified schedule of bills in hands the total of the schedule should be checked by reference to the accounts in the general ledger.
- (b) The auditor should examine each bill to see that it is properly down, signed by the acceptor and is also properly stamped.
- (c) If the bills have been deposited with a bank they should be verified on the basis of a certificate obtained from the concerned bank.
- (d) Bills subsequently met should be verified by vouching the cash received and entered in the cash book.
- (e) If the bills have been retired since the date of balance sheet the proceeds there should be checked with reference to the cash book.

**(d) INVESTMENTS**

If there are a large number of investments as in the care of banks and Insurance companies, the auditor should ask for a schedule of investment held by his client securities may be checked securities include share certificates. Government loans bonds etc. If the securities are with the bank, the auditor must obtain relevant certificate to verify such securities. If they are inverted with many parties a list should be made available to the auditor on the date of balance sheet by the management of the company. This should show names, cost, market value on the date book value, rate of interest, dates of payments of interest etc.

This list should be checked by the auditor through certain tests like market rates are checked through financial journals, securities through broker notes. IN addition to this the auditors must also see that all income from investments is properly collected and recorded.

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**QUESTION NO. 6**

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See Paper 2014 Question No. 6 & Paper 2016 Question No. 2.

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**QUESTION NO. 7**

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See Paper 2015 Question No. 7 & Paper 2017 Question No. 7 (b)

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**QUESTION NO. 8**

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See Paper 2014 Question No. 8