Auditing
B.Com Part 2
QUESTION # 1

What is audit or auditing? What are the objectives of auditing? Or Explain the concept of audit and its objectives.

ANSWER

AUDITING
Auditing is an examination of the accounting records by a qualified and independent person on the basis of the proper evidence, to express his opinion as to the truth and fairness of financial statements.

According to R.K. Mautz
“Auditing is concerned with the verification of accounting data with determining the accuracy and reliability of accounting statements and records.”

OBJECTIVES OF AUDITING

A. Primary Objectives
B. Secondary Objectives
C. Special Objectives

(A). PRIMARY OBJECTIVES
Following are the primary or principal objectives of auditing.

1. Accounting Polices
The main object of auditing is to examine the accounting policies. Accounting policies are needed for preparing the accounting records.

2. Fairness of Statements
One of the most important objectives of audit is to determine the fairness of statements. Auditor examine the books of accounts to know the reliability of financial statements.

3. Prescribed Laws
Another object of audit is to check that prescribed laws were followed or not in preparation financial statements. In Pakistan companies are governed under companies’ ordinance 1984. So auditor verify whether the requirements of Ordinance have been compiled or not.

4. Independent Opinion
Expression of independent opinion about financial statement is the main objective of auditing. After complete scrutiny auditor give his opinion in the form of report about fairness of financial statements.

(B) SECONDARY OBJECTIVES
Following are the secondary or subsidiary objectives of auditing.

5. Detection of Errors
Unintentional mistakes in accounting records and financial statements are called financial errors. Errors are generally committed unintentionally. The objective of auditing is to detect errors.
6. Detection of Frauds
Intentional mistakes in accounting records and financial statements are called fraud. Frauds are committed with intention to deceive mislead and conceal the truth. Objective of auditing is to detect the fraud.

7. Prevention of Errors and Frauds
Objective of auditing is not only to detect the errors and frauds but also to prevent them. It is not possible to prevent the errors and frauds fully but these can be minimized through efficient and effective internal control.

(C) SPECIAL OBJECTIVES
Following are the important special objectives of audit.

8. Satisfaction of Tax Authorities
The objective of audit is to satisfy tax authorities. The audited accounts are reliable. The business concern can settle the tax matters easily.

9. Loan Facilities
The objective of audit may be providing loan facilities to the organization. Banks rely on audited accounts. On the basis of audited accounts the management can get loan from banks easily.

10. To Attract Investor
The object of audit is to attract investors. The audited accounts are more reliable. Investors can make investment by relying over audited accounts.

11. Purchase Consideration
The object of audit may be to determine the real value of business. Through audited accounts the fair value of assets and liabilities can be determined.

12. Variation in Profit
The object of audit may be to check the variation in profit. By auditing the auditor can analyse the fluctuation in profit.

13. Proper Supervision
The object of audit may be the proper supervision of business. Sometimes owner cannot look after the business personally. Audit acts as a check on employees and it saves the owner from losses.

14. Prevention of Disputes among Partners
Audited accounts are considered more reliable. Where a partnership regularly gets its accounts audited, there are less chances of misunderstanding and distrust among the partners.

15. Management Audit
It is a voluntary audit. The purpose of management audit is to assess the performance, review the organizational structure and suggest best course of action.

16. Social Audit
The purpose of social audit is to measure social performance of business. The society is concerned with the protection of natural environment.
Question # 2

What are the advantages or importance of audit or auditing?

OR

Describe the benefits of getting the accounts audited to the business itself and public at large.

OR

Why accounts are got audit?

ANSWER

ADVANTAGES OF AUDITING

The advantages of auditing can be discussed under the following headings.

A. Advantages to the Business
B. Advantages to the owners
C. Advantages to the government or State
D. Advantages to general public

ADVANTAGES TO THE BUSINESS

1. Moral Check
   The fear of detection of errors and frauds acts as a moral check on the employees. Due to this check the employees become regular and more careful in their work.

2. Detection of errors and frauds
   Errors and frauds if any, committed by employees of the business in accounting records can be detected by auditing.

3. Loan facilities
   Business can easily obtain loan with the help of audited accounts because audited accounts are accepted by the lenders for granting loan

4. Business Purchase Price
   If a running business is to be sold, purchase consideration (Price) can easily be determined (Calculate) on the basis of audited accounts.

5. Tax Payments
   If accounts are audited then these are easily accepted by the tax department for the assessment of taxes and there is no need for further inquiry

6. Settlements of Disputes
   If any dispute arise among directors, partners or shareholders regarding share of profit etc. it can easily be settled through the audited accounts.

7. Settlement of Insurance Claims
   In case of loss or damage to business property due to fire, earthquake, theft etc. the audited accounts facilitate to settle the insurance claim.

8. Correct Information about Business
   Due to fear of audit, the work of accounting always remains up to date and correct information is given to the members in time.
ADVANTAGES OF AUDIT FOR OWNERS

9. Owner’s satisfaction:
In the presence of audit, the owners feel satisfaction about business operation and working.

10. Helpful for partners
The partners can rely on the audited accounts. The audited accounts help the partners to adjust their capital and determine the value of goodwill at the time of admission, retirement and death of a partner.

11. Shareholders Protection
Audit is the only way to save shareholders from exploitation. The shareholders can watch business through auditor. The auditor takes utmost care to protect their rights.

12. Deceased Estate
If the accounts are audited then the family of deceased person can rely on these accounts for distributing the estate.

13. Fluctuation in Profit
If accounts are audited then owners can easily know that what are the reasons for fluctuation of profit.

14. Making of Budget
If accounts are audited then owners can easily know the true and fair view about their business activities and they can make the budget for next year.

15. Valuable Advice
The auditor is an expert in accounting problems. The owners of the business can get valuable pieces of advice to solve the accounting problems.

ADVANTAGES TO GOVERNMENT

16. Easy assessment of Taxes:
In the presence of audited accounts the tax authorities can easily assess (calculate) the income tax, sales tax and pass the assessment order without further investigation.

17. Early recoveries of Taxes:
The assessment orders can be made by tax authorities at early date which leads to early recovery of taxes.

18. Economic Progress:
The government can check the economic progress of the various companies by going through the audited accounts. If these companies are earning reasonable profit, it shows a good sign for the economy.

19. Privatization
If some industries under government control are running in loss, the government may privatize these sick industrial units. The sale price of these industrial units is settled on the basis of audited accounts.
20. Purchase of Private Business Units
If any private business unit is not working for the welfare of the general public. The government may take over such business units. The purchase price of these units is settled on the basis of audited accounts.

ADVANTAGES TO GENERAL PUBLIC AND OTHERS

21. No lender’s Loss:
There may be no loss to lenders because banks and others financial institutions get the audited accounts before granting loan and with the help of audited accounts they can check the trust worthiness of customers.

22. Better Pay:
Audited accounts provide the true and fair view of profit, so employees can demand higher pay.

23. Investor’s Satisfaction:
The investors can easily judge the position of the company and thus make the decision to invest in one company and not others.

24. Employment Opportunities:
As organization and businesses are expanding; the need of audit is increasing, so this field is providing more and more job opportunities to the thousands of people.

25. Training Facilities
The audit assistants and clerks work under the supervision and control of auditor. They get trained and become human capital for the industry.
QUESTION # 3

Define audit. How does it differ from accounting? OR Define auditing. Also explain the difference between accounting and auditing?

AUDITING
Auditing is an examination of the accounting records by a qualified and independent person on the basis of the proper evidence, to express his opinion as to the truth and fairness of financial statements.

ACCOUNTING
Accounting is an art of recording business transactions in a systematic manner in the books of accounts and to prepare financial statements.

DIFFERENCE BETWEEN ACCOUNTING AND AUDITING / ACCOUNTANT AND AUDITOR

1. Meaning
   (a) Accounting is an art of recording business transactions in books of accounts and to prepare financial statements
   (b) Auditing is an examination of accounting records to check the fairness of financial statements.

2. Scope
   (a) Accounting refers to the preparation of financial statements
   (b) Auditing refers to examination of accounting records.

3. Data
   (a) Accounting is concerned with current data
   (b) Auditing is mainly concerned with past data

4. Objective
   (a) The main objective of accounting is to ascertain the trading results of business
   (b) The main objective of auditing is to certify the correctness of financial statements

5. Duration
   (a) Accounting work is undertaken throughout the year
   (b) Auditing is generally done at the end of trading year.

6. Report
   (a) In accounting it is not required to prepare and submit report
   (b) In auditing it is required to prepare and submit report to the owners of business.

7. Techniques
   (a) Accounting techniques include depreciation, amortization, valuation etc.
   (b) Auditing techniques include vouching, verification and valuation

8. Necessity
   (a) Accounting is necessity of every organization whether small or large
   (b) Auditing is not necessary for every organization.
9. Nature of Job
(a) Accounting job is mechanical in nature
(b) Auditing job is not so mechanical.

10. Qualification
(a) No specific qualification is required for accountant.
(b) Specific qualification is required for auditor such as for companies auditor must be chartered accountant (CA)

11. Appointing Authority
(a) The management committee is authorized to appoint accountant
(b) Owners or Securities and Exchange Commission of Pakistan (SECP) are authorized to appoint auditor.

12. Rights, Duties and liabilities
(a) Rights, duties and liabilities of accountant are fixed by business management
(b) Rights, duties and liabilities of auditor are fixed by companies ordinance 1984.

13. Employment
(a) Accountant is a permanent employee of organization
(b) Auditor is not a permanent employee or organization

14. Reward
(a) Reward of accountant is called salary
(b) Reward of auditor is called fee.

15. Removal
(a) Accountant can be removed from his job at any time.
(b) Auditor cannot be removed till he completes his period of appointment.

16. Advice
(a) Accountant has right to give advice to management on business matters.
(b) Auditor has no right to give advice to management on business matters.

17. Errors and Frauds
(a) Errors and frauds may be committed by accountant
(b) Errors and frauds are detected by auditor

18. Knowledge
(a) Accountant must have accounting knowledge
(b) An auditor must have accounting as well as auditing knowledge.

19. Evaluation:
(a) The accountant cannot determine the efficiency of its own function.
(b) Auditor also cannot determine the efficiency of its own function but he can determine the efficiency of all the business.

20. Management Influence
(a) An accountant is under direct pressure of business management
(b) Auditor is not under direct pressure of the management.
QUESTION # 4

What is Continuous audit? What are the advantages and disadvantages (drawbacks) of continuous audit?

ANSWER

CONTINUOUS / RUNNING / DETAILED AUDIT
Continuous audit is conducted throughout the year. The auditor or his staff visits the client’s office at regular or irregular intervals and check the accounting records up to the date of his visit.

According to R.G. Williams
“Continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or his staff attends client’s office at regular or irregular intervals during the period.”

ADVANTAGES OF CONTINUOUS AUDIT
Following are the advantages of continuous audit.

1. Early Detection of errors and frauds
In continuous audit the auditor checks the accounts in detail, soon after the entries have been made. In this way if there is any error or fraud it can be detected at initial stage.

2. Quick Rectification
Due to Continuous Audit errors are located easily and rectified at an early stage.

3. Detailed Checking
In continuous audit, auditor has so much time so it is possible for him to check the accounts in detailed.

4. Checks on Fraud
Due to continuous audit surprise visits of auditor are possible and due to this accounting staff become alert and there are less chances of fraud.

5. Proper Attention
In continuous audit, the auditor has ample time to examine the accounting records, so he can give proper attention to the checking of books of accounts.

6. Early Presentation of Accounts
In continuous audit, accounting and auditing is done together so in this way audited accounts can be presented to shareholders soon after the closing of the trading period.

7. Accounts up to date
In continuous audit, the auditor visits are surprise at the client’s office, so clerks always keep the accounts up to date.

8. Interim Dividend
If the directors of company decide to pay the interim dividend, continuous audit will help in preparation of interim accounts without much effort.
9. **Prompt Filing of Returns**
The continuous audit is also helpful for the prompt filing of returns. The management can submit audited account to the registrar as soon as the end of the year.

10. **Early Meetings**
This audit is helpful for the early meeting of the shareholders. The accounts are presented for the distribution of profit.

11. **Auditor Advice**
In the continuous audit the auditor can find the weakness of the business during the year and he can make the suggestion for the improvement of the business.

12. **Distribution of Work**
The work of audit continues the whole year. It is helpful in distribution of load of work on the staff.

13. **Less chances of overlooking**
Auditor has so much time, so he can consider all the important points. In this way there are less chances of overlooking the important matters.

14. **Learning for audit staff**
In continuous audit, audit work is carried out in detail. So continuous audit provide an excellent learning opportunity for junior audit staff.

15. **Encouraging Investment**
Investment is encouraged with the help of continuous audit because this audit is very helpful in controlling the irregularities.

**DISADVANTAGES OF CONTINUOUS AUDIT**
Following are the disadvantages of continuous audit.

1. **Inconvenience**
There may be inconvenience to the staff by the frequent visits of auditor and these visits may upset the work of auditor's staff.

2. **Expensive**
This type of audit is very expensive because auditor has to make many visits and perform detailed work.

3. **Thread of work is lose**
In continuous audit the auditor visits client’s office at regular or irregular intervals. The link between the past and present work may not be maintained.

4. **Staff Intimacy**
Due to frequent visits of auditor, client’s staff and audit staff may develop friendly relationship. Friendship can affect the impartiality of auditor.

5. **Not Suitable for Small Businesses**
Continuous audit is not fit for small business concerns. A small business has few transactions so there is no need of audit for whole one year.
6. Seasonal Industries
In seasonal industries like textile and sugar the volume of work is reduced in off seasons so there is no need of continuous audit.

7. Alteration in Figures
Dishonest persons may change the figures in books after the checking by auditor.

8. Increase labour
In continuous audit alteration in figures can only be avoided by taking extensive notes by auditor which increases the work of auditor.

9. Unnecessary Dependence
Frequent visits of auditor to client’s office may induce the accounting staff to depend upon auditor even for petty matters.

10. Low Income for auditor
The continuous audit keeps the staff busy for one year. They are not able to start and complete many audits at the same time. So it is not suitable for audit staff from financial point of view.

CONCLUSION
A continuous audit has both advantages and disadvantages. But it is concluded that it is suitable for large business organization where volume of work is so large.
QUESTION # 5

What is Final audit? What are the advantages and disadvantages (drawbacks) of final audit?

ANSWER

FINAL / COMPLETE / ANNUAL AUDIT
Final audit is that which is started at the close of trading period. Final is audit is continued till the audit work is completed. It is also known as periodical audit or balance sheet audit.

According to Walter W. Bigg
“A final audit is an audit which is not commenced until after the end of the financial period and is then carried on until completed.”

ADVANTAGES OF FINAL AUDIT
Following are the advantages of final audit.

1. Economical
Final audit is economical (less expensive) because the auditor charges less audit fee as compared to continuous audit. Final audit gives maximum benefits to the enterprise with minimum cost.

2. Thread of Work is not Lost
Final audit is completed in one continuous session. There is no interval between the audit works. The audit staff does not lose thread of work.

3. Less danger of alteration
In final audit whole accounting record is handed over to the audit staff. There is less danger that figures may be altered after checking by the auditor.

4. Convenient for Accounting Staff
Final audit is conducted when books of accounts have been closed. The accounting books are no more required by the accounting staff. The accounting staff works without any disturbance.

5. Minimum Time
This type of audit takes the less time of auditor. So auditor can start and complete many audits and can raise his income.

6. No Staff intimacy
Final audit is started and completed within short period. Friendly relations cannot be developed among the audit staff and accounting staff.

7. Beneficial for Small Business Units
In final audit, auditor charge less audit fee as compared to continuous audit. So it is suitable for small business concerns.

8. Beneficial for Seasonal Industries
Final audit is suitable for seasonal industries. As the management is free in off season, so they can pay more attention to auditors.
9. **Beneficial for Shareholders**
Directors normally keep the shareholders in darkness. Auditors are appointed by shareholders and they work for them. Auditor presents a true picture of the company to shareholders.

10. **Beneficial for owners**
In large-scale business, the owner of the business does not know the real position of his business. Due to final audit he comes to know about his business and final audit provides his satisfaction.

11. **Guidance**
The auditor not only provides the true and fair information but also guides the management on how they can improve their accounting systems.

12. **Legal Requirement**
Final audit is compulsory for Joint Stock Company. Final audit has an advantage that it fulfills the requirement of law.

13. **Check on Accounting Staff**
Accounting staff knows that during the course of final audit the auditor will detect any error and fraud in the accounts. It creates pressure on accounting staff and they work carefully and honestly.

14. **Improvement of internal control system**
Final audit is effective only when there is a strong system of internal control. Therefore, management and the auditor both adopt measures for the improvement of internal control.

**DISADVANTAGES OF FINAL AUDIT**

1. **Delay in Report**
The decisions of the business are made on the basis of the audit report. But in final audit this report is made one or two months late. So there is also delay in the making of important decisions.

2. **Late correction:**
In final audit, errors are located after the end of the year. The correction of errors takes time. Late deduction of errors and fraud may cause huge losses to the business.

3. **Planned Frauds**
In this type of audit, the management has a whole year to think and decide how to make the frauds. So they commit a planned fraud, which is very difficult to find by the auditor.

4. **Test checking:**
In final audit the most popular techniques of test checking is applied. Audit risk is maximized so chance of error and fraud increase.

5. **Non applicability:**
It is not applicable where internal controls of the company are weak or volume of transactions is very large.
6. May Misrepresent
There may be also a chance that audit report may not represent the correctness of accounts because each and every transaction is not checked. Wrong reports may lead to wrong decisions which may cause losses in future.

7. Shortage of time
The auditor has several clients whose financial year end on the same time, so it may be difficult for the auditor to complete the work of all clients in time.

8. Proper Attention
The auditor cannot pay the proper attention towards the audit because he is bound by the fixed time.

9. Disturbance in next year work
As this audit is completed in beginning months of next accounting period, so it disturbs the next year’s work.

10. Monthly Report
Final audit is not suitable for those businesses where monthly or quarterly reports are required.

CONCLUSION

We conclude that this type of audit is most suitable for small and medium scale business organizations. The cost of this audit is also very low. This type of audit is widely used by auditors in Pakistan, so it is a popular type of audit.
QUESTIONS # 6

What is the difference between continuous and final?

ANSWER

DIFFERENCE BETWEEN CONTINUOUS AND FINAL

1. Popularity
   (a) Continuous audit is less popular as compared to final audit
   (b) Final audit is more popular as compared to final audit

2. Nature of audit
   (a) Detailed checking of accounting records is done
   (b) Test checking is done instead of detailed checking

3. Suitability
   (a) Continuous audit is suitable for large organizations
   (b) Final audit is suitable for medium and small organizations

4. Time for audit work
   (a) In continuous audit the auditor gives more time for audit work.
   (b) In final audit the audit work is completed in short time.

5. Audit fee
   (a) High audit fee is paid for continuous audit
   (b) Low audit fee is paid for final audit

6. Moral Check
   (a) Continuous audit puts more moral check upon the accounting staff
   (b) Final audit puts less moral check on the accounting staff

7. Commencement time
   (a) Continuous audit is commenced when entries and records are being made.
   (b) Final audit is commenced when entries and accounting records have been completed

8. Future Planning
   (a) In continuous audit, the audited accounts are prepared in time, so planning is right on time.
   (b) Final audit is conducted after the end of trading period, so future planning is delayed.

9. Chances of errors and frauds
   (a) In continuous audit, the chances of errors and frauds are reduced
   (b) In final audit, the chances of errors and frauds are high

10. Interim dividend
    (a) In continuous audit, interim accounts can be prepared, so interim dividend can be declared.
    (b) In final audit, interim accounts cannot be prepared, so interim dividend cannot be declared
11. Internal Control
(a) Continuous audit may be conducted even if there is poor internal control system
(b) Final audit may be conducted only if there is effective internal control system

12. Applicable
(a) Continuous audit is applicable in those organizations where early audited accounts are required
(b) Final audit is applicable in those organizations where early audited accounts are not required

13. Alteration in figure
(a) In continuous audit there are more chances of alteration in audited accounts
(b) In final audit, chances of alteration in figures are less

14. Deduction of errors and frauds
(a) In continuous audit errors and frauds can be detected during the trading period
(b) In final audit, errors and frauds are detected at the end of trading period

15. Convenient for clients
(a) Continuous audit is not convenient for client as it disturbs the clients work
(b) The final audit is convenient for the client as it does not disturb the clients work.

16. Correction of errors
(a) The continuous audit is helpful for early correction of errors
(b) In final audit the errors are corrected late.

17. Staff intimacy
(a) In continuous audit, there are ample chances of staff intimacy
(b) Final audit provides no chances of staff intimacy

18. Scope
(a) There is detailed and complete checking of account books and records in continuous audit.
(b) There is no detailed and complete checking of accounts books in final audit.

19. Visits
(a) In continuous audit the auditor visits the client office most frequently such as daily, weekly, fortnightly or monthly.
(b) In final audit the audit is completed in one continuous session.

20. Surprise Visits
(a) In continuous audit may make surprise inspections.
(b) In final audit there are no surprise inspections by auditor.
QUESTION # 7

Define interim audit. Discuss its merits and demerits. (2010)

ANSWER

Interim Audit:
Interim audit is that audit which is conducted between the two annual audits for the purpose of finding the interim dividend. It also minimizes the work and time involved in final audit. These types of audit may be monthly, half yearly or quarterly.

According to L.R Howard
“When an audit is conducted to a particular date within the accounting period, it is called interim audit”.

Advantages of interim audit:

1. Interim dividend:
Interim audit is conducted to declare interim dividend. The shareholders feel satisfaction over the business.

2. Early deduction of errors and frauds:
The frauds and errors can be deducted early due to interim audit. Early deduction of errors and frauds can minimize future losses.

3. Auditor suggestions:
The accounting staff can follow auditor suggestion. Auditor’s advices are useful for better performance of business during the year.

4. Increase in profit
By implementing the auditor’s suggestions the deficiencies in accounting system can be removed. The performance of the management can be improved. So, interim audit provides chances to increase profit.

5. Comparative study of financial results
Interim audit reports show quarterly or half yearly financial results. These results are compared with final results to know the direction of profitability.

6. Planning:
Interim audit is helpful for making plans for remaining part of a year. We can increase the profitability of business due to better planning.

7. No over work:
In case of interim audit, there is no over work because the audit work is less. The audit staff can complete the audit work easily according to time table.

8. Moral check:
When the staff of the client knows that at any time during the year accounts are checked for the interim period then they will not commit any fraud.
9. **Accounts up to date**
In interim audit, the auditor examines the accounting records during the trading period. The accounting staff becomes regular and maintains the accounting records up to date.

10. **Making investment:**
Interim results are useful for investors. They can rely on audited accounts for making investment.

11. **Early presentation of audited accounts**
In case of interim audit, most of the audit work has already been performed during the trading period. The final audit can be completed early and audited accounts can be presented to the shareholders soon after the closing of trading period.

12. **Convenient**
Interim audit is very convenient for the management because they invite the audit staff when their business activity is low.

13. **No Staff intimacy**
In interim audit, the audit time is short and audit staff does not visit the client’s office frequently. There are no chances of staff intimacy.

14. **Case of New Partner**
At time of admission of new partner in a business it is necessary to determine the correct position of assets and liabilities. For the determination of values of assets and liabilities during the year interim audit is very helpful.

15. **Retirement and Death Case**
If any partner dies or wants to leave from the business then interim audit can easily determine the correct position of its assets and liabilities.

**Disadvantages of interim audit:**

1. **Figures alteration:**
In interim audit after completion of work books are returned to accounting staff. Figures can be changed by accounting staff after the end of the audit.

2. **Additional work:**
To prevent the alteration of figures, it is necessary for audit staff to keep notes of important balances and totals. Note taking is an extra work for an auditor

3. **Test checking:**
In interim audit, test checking technique is followed. Audit risk is maximized because interim financial statements will be based on sample results.

4. **Additional expense**
Interim audit increases the business expenses. Interim audit is optional for management, so audit fee is an expense for business.

5. **Work suffers:**
Interim audit creates troubles for accounting staff. When accounting books are collected by audit staff, the client work suffers as books are not available for making entries.
6. Limited Scope
Interim audit is extra financial burden for the organization. Small business units cannot afford this financial burden. Thus, scope of interim audit is limited to large business units only.

7. Useless for third party
Interim audit provides interim results. These results are not final. The interim results do not provide guidelines for third party. So interim audit is useless for third party.

Conclusion:
We concluded that there are certain disadvantages but its benefits are more than its disadvantages. This type of audit is suitable for medium and large size business. The auditor can pay more attention towards the work. Investor also rely more on business.
QUESTION # 8

Explain the terms ‘internal control’, ‘internal check’ and ‘internal audit’. What are the principles of internal control?

ANSWER

INTERNAL CONTROL

Internal control means the whole system of control adopted by the management of a business for safe guarding of accounting records.

According to Meigs

“Internal control consists of all measures taken to provide management with assurance that everything is functioning as it should.

Internal control includes
(i) Internal check
(ii) Internal audit
(iii) Safety measures

INTERNAL CHECK

Internal check means a system by which the work done by one person is automatically checked by another person. In this way the chances of errors and frauds are minimized.

Example

When a bill is prepared by a clerk, it is checked by manager. Then after manager’s checking it is sent to chief accountant for the final approval.

INTERNAL AUDIT

Internal audit is a system by which the work performed by one department is checked by another department of the same business.

SAFETY MEASURES

Safety measures mean the measures adopted by the management for the protection of assets from wastage and theft. Such as management employ the gate keeper.

PRINCIPLES OF INTERNAL CONTROL

Following are the principles of internal control

1. Plan of Organization

For good internal control system there should be an appropriate plan and structure of the organization. Organizational structure provides for the proper assignment of authority and responsibility.

2. Sound Practices

An internal control system requires sound practices to be followed in the performance of duties and functions of each department of the organization.

3. Managerial Supervision

The management of the organization should regularly supervise and review the financial position of the organization. The supervision and review will help the management to know whether things are going on as they should or not.
4. **Double Entry System**
Double entry system must be used for recording the business transactions. The duties must be allocated to different persons in regarding the different parts of transactions.

5. **Competent Staff**
Competent staff must be employed for the effective handling of functions. Incompetent employees reduce the efficiency of internal control.

6. **Sufficient Staff**
Keeping in view the nature and size of organization the management should appoint sufficient staff.

7. **Division of Work**
The work of the organization should be divided among the staff members according to their training and abilities. No one should be allowed to perform the work from original to end.

8. **Rotation of Duties**
Rotation of duties and job is the important principle of internal control. No staff member should be allowed to perform the same duty for a long time.

9. **Use Modern Appliances**
Modern mechanical appliances such as cash registers, accounting machines should be used.

10. **Clear Cut Duties**
Duties for the performance of job must be clearly stated. Only one job must be given to one person because one person can perform only one job in better way.

11. **Clear Cut Instructions**
Clear cut instructions should be given by top level management to lower management and to workers. Instructions should be given in black and white instead of verbal instructions.

12. **Clear Rules and Regulation**
The rules, regulation and policy of the management should be clear to the employees. Every employee should perform his function according to rules and regulations.

13. **Proofs of Work Done**
There should be proofs of the work done by each employee of the organization. The staff should therefore, initial invoices, bills, receipts etc.

14. **Detail Records**
Detail records should be maintained of goods received and sent out, cash received and paid and assets purchased.

15. **No Complete Confidence**
There should not be too much confidence on any because a reliable person may also commit a fraud for his benefit. In business mostly frauds are occurred by trusted persons.

16. **Proper Incentive**
Management should introduce different incentive plans to the hard working and honest employees. Incentive plans increase efficiency and reduce chances of errors and frauds.
17. **Confirmation to Outsiders**
Direct confirmation to outsiders is an important principle of internal control. Debtor balances may be checked by direct communication to debtors to check the accuracy of accounting records.

18. **Correspondence**
All daily correspondence received should be open daily by a responsible officer. The mail must be opened in the presence of a reasonable officer.

19. **Remittance and deposits**
All remittances and receipts should be deposited in the bank as soon as possible.

20. **Physical inspection of cash and bank**
Cash balance and bank balance must be physically checked by the responsible officials.
QUESTION # 9

What is meant by Internal Audit? How does it differ from External Audit?

ANSWER

Internal Audit
Internal audit is a part of internal control system. It is continuous examination of accounting records throughout the year by the staff of the concern. The scope of internal audit is determined by management. We can define it as

“Internal audit is the continuous process of examining accounting records of a concern by its own full time salaried persons.”

DIFFERENCE BETWEEN INTERNAL AND EXTERNAL AUDIT

1. Scope
   (a) The scope of internal audit is determined by the management
   (b) The scope of external audit is determined by the law.

2. Change of Scope
   (a) The scope of internal audit can be changed by the management at any time
   (b) The scope of external audit cannot be changed by the management

3. Legal Entity
   (a) Internal audit is a part of the entity
   (b) External audit has a separate entity apart from the organization

4. Objective
   (a) The main objective of internal audit is to detect and prevent errors and frauds.
   (b) The main objective of external audit is to show fair and true view of accounting records

5. Legal Requirement
   (a) Internal audit does not fulfill the legal requirement of any organization
   (b) External audit fulfill the legal requirement of any public Ltd. Company

6. Internal Control
   (a) Internal audit is a part of internal control
   (b) External audit is not a part of internal control

7. Duration
   (a) Internal audit may continue for the whole year
   (b) External audit may be completed within a week or a month

8. Report
   (a) In internal audit the report is submitted to the management
   (b) In external audit the report is submitted to the shareholders.

9. Test Checking
   (a) In internal audit the test checking techniques cannot be adopted
   (b) In external audit the test checking techniques can be adopted
10. Auditing Standards
(a) It is not necessary in internal audit to comply with the international standards on auditing
(b) It is necessary in external audit to comply with the international standards

On auditing

11. Appointment
(a) The internal auditor is appointed by the management
(b) The external auditor is appointed by shareholders

12. Removal
(a) The internal auditor can be removed by the management at any time
(b) The shareholders can remove the external auditor

13. Qualification
(a) For internal auditor there is no prescribed qualification
(b) The external auditor must be chartered accountant (CA)

14. Status
(a) Internal auditor is an employee of the organization
(b) External auditor is an independent professional person.

15. Rights, Duties and Liabilities
(a) The rights, duties and liabilities of internal auditor is determined by management
(b) The rights, duties and liabilities of external auditor is determined by law

16. Remuneration
(a) The remuneration of internal auditor is called salary
(b) The remuneration of external auditor is called audit fee.

17. Meetings
(a) Internal auditor has no right to attend statutory or annual general meeting of the company
(b) External auditor has right to attend statutory or annual general meeting of the company

18. Suggestions
(a) Internal auditor can give suggestions to improve accounting and other systems of the org.
(b) External auditor cannot give suggestions for the improvement of internal control

19. Liable
(a) In case of fraud the internal auditor is liable to management
(b) In case of fraud the external auditor is liable to shareholders

20. Legal Proceedings
(a) The internal auditor cannot be called by court in any legal proceedings
(b) The external auditor may be called by court in any legal proceedings
QUESTION # 10

Explain the basic Principles of internal control suitable for a manufacturing business.

ANSWER

SYSTEM OR PRINCIPLES OF INTERNAL CONTROL FOR A MANUFACTURING CONCERN

The management of a manufacturing concern should give due importance to the following steps while designing a proper system of internal control.

1. Adequate and Competent Staff
   The first requirement for a proper internal control system is that adequate and competent staff should be available. If staff is not sufficient and competent, there will be delay to complete the work.

2. Correspondence
   All incoming correspondence should be daily opened by a responsible official. Proper record should be made both for incoming and outgoing dak (letter).

3. Remittances
   All remittances must be recorded into a cash book and handed over to the cashier who should deposit all remittances into bank the same day.

4. Printed Receipts
   Printed receipts should be issued for cash received. These receipts should be signed by one or two authorized officials. Unused receipt books should be kept under lock and key.

5. Payments
   All payments should be properly authorized by a competent authority. As far as possible, all payments should be made by crossed cheques.

6. Wages and Salaries
   Wages and salaries sheet should be checked by senior staff member. Payment of wages should be made in the presence of factory manager or foreman personally knowing the workers.

7. Record of Materials
   A complete record of materials received and issued should be maintained. Physical checking of materials must be carried out ( ) by responsible official frequently ( ).

8. Cash Sales
   Proper care should be taken that cash sales are made at correct price. There are ample ( ) chances of misappropriation of cash, therefore, cash sales must be adequately supervised.

9. No Access to ledgers
   The work among the staff members should be divided in such a way that the person making entries in journal should have no access to ledgers and ledger keeper should not make entry in the books of original records.
10. Petty Cash
Small payments of cash should be recorded in petty cash. Senior cashier should check the petty cash book balance from time to time.

11. Surprise Inspection
Surprise inspection of cash book should be done by a responsible official. Balance in cash book must be reconciled by physical counting of cash in hand.

12. Credit Notes
Credit notes for returns and allowances should be authorized by a competent authority.

13. Statement of Accounts
Statement of accounts sent to customers should be checked by a responsible official. Special measures must be taken for the collection of over-due accounts.

14. Physical Protection
Proper measures must be adopted to protect the assets and valuable items of the organization. There should be security arrangements to check unauthorized entrance and exit of goods.

15. Dispatch of Goods
Goods must be dispatched after obtaining the approval from a competent authority. Proper record should be maintained for the dispatch of goods.

16. Vouchers
All supporting vouchers should be serially numbered and kept in safe custody to facilitate the checking by the auditor.

17. Arithmetical Accuracy
Arithmetical accuracy of books of accounts should be checked by a responsible official.

18. Modern Office Machines
Modern office machines such as fax machines, computers etc. should be used. By the use of modern office machines, the chances of errors and frauds are reduced.

19. Review of work Done
There should be a proper system under which the work done by staff members may be reviewed at intervals by the senior official.

20. Proofs of work Done
The staff should initial the vouchers and documents after having performed the duties assigned to them. This will provide proof of work done by staff members.
QUESTION # 11

What is meant by internal check? Suggest a good system of internal check over cash.

Answer

INTERNAL CHECK
Internal check means a system under which the accounting work is arranged in such a way that the work of one staff member is automatically checked by another. Under this system possibility of errors and frauds is minimized.

SYSTEM OF INTERNAL CONTROL or CHECK OVER CASH
System of internal control over cash transactions should be designed with utmost care because now-a-days misappropriation of cash has become quite common.

The control over cash can be divided into two sections

1. Cash Receipts
2. Cash Payments

CASH RECEIPTS

1. Acknowledgement
For every amount received, official receipt must be issued. The counterfoil or carbon copy of the receipt should be kept in record.

2. Remittances Received
The remittances received such as drafts, cheques, cash etc. must be entered daily in cash book.

3. Deposits into Bank
All collections such as cash, cheques, bank drafts etc., must be deposited into bank as soon as possible

4. Disbursement Purpose
Cash for disbursement purpose should not be withdrawn from cash receipts.

5. Bank Reconciliation Statement
Cash book and bank statement must be reconciled from time to time. In case of difference of balances, the bank reconciliation statement should be prepared.

6. Cash Sales
Cash sales must be subject of sound system of recording and checking, so that chances of misappropriation of cash are reduced.

7. Surprise Inspection
Surprise inspection of cash book should be done by a responsible official. Balance in cash book must be reconciled by physical counting of cash in hand.

8. Credit Notes
All credit notes for returns and allowances must be approved by the chief accountant or any other competent authority.
9. Payment Through cheques
Customers must be asked to make payments through crossed cheque. In this way chances of misappropriation of cash will be minimized.

10. Petty cash
Small payments of cash should be recorded in “Petty Cash Book”. Senior cashier should check the petty cash book balance from time to time.

11. Un-used Books
The receipt books must be issued to the cashier one by one, so that he may not use some pages of unused receipt book.

12. Serial Number
The receipts should be consecutively numbered and these numbers should enter in the books of account for avoiding errors and frauds.

CASH PAYMENT

13. Authorization
All payments should be authorized by competent authority. Proper verification must be done before payments are made.

14. Mode of Payments
All payments beyond a certain amount must be made by crossed cheques marked “Payee’s account only”.

15. Arrangements of receipts
All receipts of payments should be properly arranged chronologically. These receipts must be preserved through proper filing.

16. Recording all Payments
All payments should be promptly recorded in the cash book. The counter-foil of issued cheques and vouchers may be the basis for recording the payment in cash book.

17. Blank Cheques
Blank cheques must be kept under lock and key with some responsible person.

18 Spoiled Cheques
Spoiled cheques should be defaced to eliminate any further use and should be filed in regular sequence of paid cheques.

19. Statement of Accounts
Monthly statement of account should be received from creditor. These statements must be compared with the accounts maintained by the account department of the client.

20. Proofs of work done
The staff should initial the vouchers, documents and accounting records after having performed the duties assigned to them.
QUESTION # 12

Explain the terms internal check, internal audit, and internal control. Suggest a suitable system of internal check over Sales or Credit Sales. (2012)

ANSWER

INTERNAL CHECK / CONTROL SYSTEM OVER SALES or CREDIT SALES
The following steps can be taken for effective and strong internal control over credit sales.

1. Sales Department
Sales of goods should be supervised and controlled by sales department. The sales department should be headed by a responsible official.

2. Receiving Orders
The goods should be sold against written order. If verbal or telephonic orders are received, written confirmation must be obtained for customers.

3. Acceptance of Order
Before an order is accepted, approval of competent authority of various departments should be received. After securing approval, the customer is informed about the acceptance of his order.

4. Agreement
Sales agreement should be made with the customers. Sales agreement should contain all terms and conditions for the supply of goods.

5. Arrangement of Goods
After the settlement of terms and conditions next step is the arrangement of goods. The warehouse manager or production manager should be asked to arrange the goods within the delivery period.

6. Tally Goods
When the goods are ready for delivery, the responsible person should tally goods with the sales order.

7. Preparation of Sales Invoice
Next step is the preparation of sales invoice. Sales invoice should be prepared in duplicate form. Care should be taken that the sales invoice should be prepared at correct price.

8. Dispatch of Goods
After receiving goods from warehouse of from production manager, the dispatch department should make necessary arrangement for the delivery of goods according to the instruction of the customers.

9. Record in Sales Book
From the copy of the invoice, entry should be made in goods outward book. Goods outward book should be checked at regular interval by a responsible official.

10. Filing Sales Order
The sales department should file the sales order date-wise. The filing of sales order is necessary for future reference.
11. Sales Return
The goods returned from customer should be entered in sales return book with the permission of responsible official.

12. Credit Note
A responsible person should prepare credit note for goods returned. It should be issued to the customer immediately.

13. Collection from Customer
If payment is not received within time period, the customers must be asked to make immediate payment through crossed cheques or bank draft. The collections should be recorded in cash book immediately.

14. No Access to Record
Sales department should have no access to make entries in the cash book. Similarly cashier should not be allowed to make entries in sales book.

15. Customer’s Enquiries
A responsible official should be authorized to deal with customer’s enquiries, overdue accounts and writing off bad debts.

16. Review of Work Done
There should be a proper system under which the work done by staff members must be reviewed at intervals by senior officials.

17. Proofs of Work Done
The staff members should initial the sales agreement, sales invoices, goods outward book, credit note and other documents after having performed the duties allocated to them. This will provide proof of work done by staff members.

18. Suggestions But not Guarantee
The steps explained above if properly implemented are expected to minimize the chances of errors and frauds in connection with sales of goods. These steps cannot not be considered as a guarantee against errors and frauds.
QUESTION # 13

Suggest a good system of internal control over purchases.

ANSWER

INTERNAL CONTROL SYSTEM OVER PURCHASES
For a proper control over purchases the following rules may be adopted.

1. Purchase Department
Purchases should be supervised and controlled by a purchase department. This department should be headed by a responsible officer.

2. Purchase Requisition
Each head of the department should submit requisition bearing the detail of items to be purchased. The purchase department should keep record of requisition received from different departments.

3. Quotations
Upon receipt of a requisition, the purchase department should call quotations from at least three listed suppliers, asking them to quote their rates, quality, delivery period and other terms of supply of material.

4. Placing the Order
The purchase department should examine the terms quoted by different suppliers. The purchase department should place the purchase order with the supplier who offers best quality of material at minimum price.

5. Purchase Contract
Purchase contract must be made with the supplier. Purchase contract should contain all terms and conditions of supply of material.

6. Physical Inspection
When goods are received the items of goods should be weighed or physically counted. Experts should inspect the quality and quantity of goods received.

7. Comparative Statement
A comparative statement should be prepared showing the order made and the materials received.

8. Returning the Defective Goods
If goods received are defective or not according to purchase order, such goods must be returned to the supplier and should be recorded in the return outwards register.

9. Checking of Invoices
The purchase department should thoroughly check the invoices regarding quality, quantity, weight, price, calculation etc., and send the same to the accounts department for payment.

10. Recording of Invoice
Accounts department should immediately record the purchases transaction in purchases book. The purchase invoice should be serially numbered and properly filed.
11. **Payment of Invoice**
Competent authority should pass the invoice for payment. The payment must be made through crossed cheque market “Payee’s account only”.

12. **Cash Book Entry**
The cheque issued for payment of purchase invoice should immediately be entered in the cash book.

13. **Review of Work Done**
There should be a proper system under which the work done by different staff members must be reviewed and checked at intervals by the senior officials.

14. **Proofs of work Done**
The staff members should initial the purchase requisitions, purchase order, invoices and other documents and accounting records after having performed the duties allocated to them. This will provide proofs of work done by staff members.

15. **Suggestions But not Guarantee**
The above mentioned steps, if properly implemented are expected to minimize the chances of errors and frauds in connection with purchase of materials. These steps cannot be considered as a guarantee against errors and frauds.
QUESTION # 14

Define internal control. Suggest a suitable system of internal control for a large scale departmental store (2014)

INTERNAL CONTROL SYSTEM OVER DEPARTMENTAL STORE
The following steps can be taken for effective and strong internal control over departmental store.

PURCHASE DEPARTMENT

1. Organization of Purchases
When goods are needed by any department, its head send the purchase requisition to the purchasing department. Purchase requisition shows the price, quantity and time in which goods are required.

2. Quotations
Quotations or tenders should be called. Then it should be decided to buy from that seller whose prices are low.

3. Written order
Order must be placed in writing to that seller whose prices are low and quality is better. Written order creates legal obligation.

4. Purchase Contract
Both parties, buyer and seller, prepare the documents for purchase contract. These documents include the price, quality and quantity of goods to be purchased.

5. Basis of Purchases
Credit purchases should be preferred over cash purchases. However discount should be demanded if purchases are made on cash.

6. Limits
There should be well established limits for
   (i) Ordering Level
   (ii) Minimum Level
   (iii) Maximum Level
These limits provide a fixed purchase policy. Due to these limits chances of irregularities are minimized.

ARRIVAL TO STORE

7. Goods Received Note
After receiving the goods, these must be physically checked, counted or weighted. Then recorded in document called “Goods Received Note”.

8. Quality Checking
Quality of all goods received must be checked at the store. If goods are according to specification, a report of satisfaction must be sent to purchasing department. If goods are not satisfactory then these must be returned to supplier with letter of complaint.
9. Recorded in Store Ledger Card
When goods are received, must be immediately recorded in store ledger card. Store ledger card contains the date of arrival, quantity, quality and description.

ACCOUNTS DEPARTMENT AND CASHIER

10. Checking of Invoice
Department should check the invoice of goods received from supplier. Following procedure is adopted in this respect:

   (i) Verification of rates
   (ii) Verification of quantity, description and goods received note.
   (iii) Stamped and signed by authorized person.

11. Purchase Book
Accounts department is also responsible to record the transaction in purchase book on the basis of copy of the purchase order.

12. Payment
A responsible officer should pass on payment of invoices. Before signing the cheques, he should assure himself about the correctness of the account.

13. Discount
Discount must be deducted from early payments. Often frauds and errors are committed when discount received but not counted.

14. Purchases Return
If goods are returned to supplier, entry must be passed in purchase return book. Delay in recording may show the difference in book inventory and physical inventory.
QUESTION # 15

Who is Auditor? Briefly explain the qualification and disqualification of an auditor of a public limited company (2009)  

OR

Explain the legal provisions governing the appointment and removal of an auditor in a listed company / Public Ltd company. (2011, 12, 14)

AUDITOR
According to F.A. Martin
“An auditor is a person appointed to examine the books of account and the accounts of a registered company to report upon them to the company members.”

QUALIFICATION OF AN AUDITOR
According to Companies ordinance 1984 a person shall be qualified for appointment as auditor of
(a) A public Limited Company
(b) A private limited company which is a subsidiary of a public limited company
(c) A private limited company with capital of three million or more

If he is a chartered accountant within the meaning of the Chartered Accountant Ordinance 1961.

In addition to a chartered accountant, a cost and management accountant within the meaning of the Cost and Management Accountant Act 1966, shall also be appointed as auditor of a private limited company with capital of three million or more.

DISQUALIFICATION OF AUDITOR
The following persons cannot be appointed as an auditor of a company.

(a) Any director, officer or employee of the company
(b) A person who was a director, officer or employee of the company in preceding three years.
(c) A person who is a partner of a director, officer or employee of the company.
(d) A person who is an employee of a director, officer or employee of the company.
(e) The spouse of a director of the company
(f) A person who is indebted of the company

APPOINT OF AUDITOR

1. FIRST AUDITOR

By Directors
For a newly incorporated company, first auditor shall be appointed by the directors within the 60 days of the date of incorporation of company. The auditor so appointed shall hold office until the conclusion of the first annual general meeting.

By Shareholders
If directors fail to appoint the auditor then shareholders have a right to appoint the auditor within in next 60 days.
By Security and Exchange Commission
If directors and shareholders fail to appoint the auditor within 120 days then the Security and Exchange Commission of Pakistan (SECP) has a right to appoint the first auditor.

2. SUBSEQUENT APPOINTMENT
Every company shall at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

3. CASUAL VACANCY
The directors may fill any casual vacancy in the office of an auditor but, while any such vacancy continues, the surviving auditor if any may act.

Any auditor appointed to fill casual vacancy shall hold office until the conclusion of the next annual general meeting.

REMUNERATION OF AUDITOR
The remuneration of the auditor of a company shall be fixed

By Directors
If auditor is appointed by the directors then they fix the remuneration of auditor.

By Shareholders
If auditor is appointed by the shareholders then they fix the remuneration of auditor.

By SECP
If auditor is appointed by security and exchange commission of Pakistan then Commission will fix the remuneration of auditor or auditors.

REMOVAL OF AUDITOR

Removal of First Auditor
The company in general meeting may remove the first auditor or auditors. Another auditor may be appointed in the place of first auditor in the general meeting.

Removal of Subsequent Auditor
The subsequent auditor can be removed by the shareholders in the annual general meeting of the company. There is need for permission from federal government for removal of auditor before expiry of period of his appointment.

Notice of Removal
When shareholders proposes to pass a resolution at annual general meeting for the removal of the present auditor, they must give a notice to the company before 14 days of meeting.

On receiving the notice the directors discuss and approve the removal of auditor in the Board meeting. The Company shall send a copy of such notice to the retiring auditor and also send notice to its shareholders not less than 7 days before the date fixed for annual general meeting.
QUESTION # 16

Briefly discuss the rights and duties of an auditor of Joint Stock Company / Public Ltd Company/ Listed Company. (2010, 13)

RIGHTS OF AUDITOR
According to companies Ordinance 1984 following are the rights of auditor.

1. To Hold Office
An auditor once appointed by directors or by shareholders or by security and exchange commission of Pakistan shall hold office till the conclusion of next annual general meeting.

2. Access to Books of Accounts
Auditor of a company shall have a right of access at all time to the books, papers and vouchers of the company, whether kept at the registered office of the company or elsewhere.

3. Right to Call Further Information
Auditor has a right to enquire from the director and other officers of the company such information and explanation as he thinks necessary for the performance of his duties.

4. Access to Books of Branches
Auditor has the right to look into the books and records of branches other than the head office. He can visit the branch office to confirm the records and statements rendered by the branch to head office.

5. Receive Notices
An auditor has a right to receive all notices relating to any general meeting which any member of the company is entitled to receive.

6. Attend Meetings
The auditor has a right to attend annual general meeting of the company. During meeting there may be discussion about business accounts. The auditor has a right to make clarification.

7. Right to Read Report in Meeting
The auditor has a right to make a report to the members of the company on financial statements and to state whether the financial statements show a true and fair view or not.

8. Right to Sign the Report
The auditor of the company has a right to sign the report. The report of auditor’s shall be dated and indicate the place at which it is signed.

9. Seek Opinion
The auditor has right to seek opinion from experts. While reporting to the shareholders, he is required to give his opinion only and not the opinion of others.

10. Right to Be Assisted
It is the right of the auditor that he must be assisted by the directors, officers and other accounting staff. If an auditor is not assisted during the conduct of audit knowingly the concerned may be fined.
11. Receive Remuneration
The auditor has a right to receive remuneration for work done under an agreement. The auditor has a right to receive the remuneration in cash.

12. Right of Lien on the Books of Account
If the auditor is not paid his audit fee, he has the right to retain the books of account till he is paid his remuneration.

13. Make Correction
The auditor has a right to make correction of any mistake. If there is any mistake then he can issue a revise statement.

14. Self-Justification
If auditor is removed by passing a resolution in annual general meeting, he can justify his position by giving representation in annual general meeting.

15. Right to Be Indemnified
If any loss is sustained by auditor due to prosecution brought into action against him, such losses must be compensated if auditor had committed no default.

DUTIES OF AUDITOR
According to Companies Ordinance 1984, following are the duties of auditor.

1. Certify the Statutory Report
It is the duty of first auditor of public limited company to certify the accuracy of the contents of the statutory report.

2. Prepare Report for Prospectus
It is the duty of auditor to prepare the prospectus report. The prospectus is issued by the company for the sale of shares and debentures.

3. Annual Report
The principal duty of auditor is to make a report to the members on the books of accounts examined by him.

4. Sign Report
The auditor should prepare and sign the audit report. A report without auditor’s signature is not valid. He should prepare the report according to the rules of audit.

5. Duty to Obtain Information
It is the duty of auditor to obtain all information and explanation which to the best of his knowledge are necessary for the purpose of audit.

6. Duty to Express Opinion
It is the duty of auditor to express his opinion on accounts and financial statements of the company.

7. Duty to State Negatives with Facts
Where the auditor in his report to members give a negative or qualified opinion, it is the duty of the auditor to state the reason for such opinion.
8. **Duty to State Additional Matters**
The Government may demand additional information along with audit report. It is the duty of auditor to provide such information to Government.

9. **Duty to Assist the Inspector**
Sometimes Government appoints the inspector for obtaining the information about the matters of company. So it is the duty of auditor to provide the true information to inspector.

10. **Duty to Certify Directors Declaration of Solvency**
In case of voluntary winding up of the company by members, declaration is to be given about solvency of the company by the directors. It is the duty of auditor to certify the solvency of the company.

11. **Complete Agreement**
The auditor is bound to perform all jobs according to terms of employment. The legal duties of auditor remains unchanged but he can perform extra duties.

12. **Secrecy**
It is the duty of auditor to maintain the secrecy about facts and figures of client’s business.
QUESTION # 17

Discuss the qualities of a good auditor.

QUALITIES OF AUDITOR
Following are the essential qualities of auditor.

(A) PROFESSIONAL QUALITIES

1. Accounting
The auditor must be well versed in all branches of accounting such as financial accounting, cost accounting, managerial accounting. It is not possible for a person to audit the accounts unless he himself knows how to prepare them.

2. Auditing
He must have up to date knowledge of auditing. He must be master of techniques of auditing. He must know how to check the financial statements, records and operation of any concern.

3. Business Law
The auditor must possess the knowledge of business law. He must have the complete knowledge about contract act, sales of goods act, bailment, partnership, agency and negotiable instruments.

4. Taxation Law
The auditor must have the knowledge of all taxation laws. Government imposes many taxes on business such as income tax, sales tax etc. so if the auditor does not know the rates of taxes then he cannot perform his services very well.

5. Company Law
The knowledge of company law is also necessary for an auditor. He must have the full knowledge of companies’ ordinance 1984, Modarba Companies Ordinance 1980, and Banking Companies Ordinance 1962. If the auditor has no knowledge then he cannot examine the statements of these companies.

6. Computer
The auditor must be expert in computer because these days nearly all the big entities are computerized. So without the knowledge of computer, he cannot perform his work very well.

7. Budget Preparation
The auditor must have the knowledge that how is budget prepared. In business the budgets are prepared about all functions.

8. General Knowledge
The auditor must have the general knowledge about political and economic conditions which can affect the business.

9. Detector of Errors and Frauds
The auditor must be expert in detecting the errors and frauds. He must encircle all vicious and bad areas well in time.
(B) PERSONAL QUALITIES

10. Tactful
He must be tactful in particular situation. He should ask the questions in such a way that it
does not show his ignorance or weaknesses.

11. Independence
Independence is an essential quality of an auditor. The auditor must perform his work with an
independent attitude. He should perform his duties without any influence or pressure from
client or anybody else.

12. Intelligent
The auditor must be intelligent so that he can easily understand the technical details of any
business. He must be able to estimate the value of any information and explanation given to
him.

13. Patience
The auditor must have the quality of patience. Before signing the documents, he must check
the evidence. He must take his time to go through the accounts.

14. Sincere
The auditor must be sincere with the client. But he must not work in the interest of
management. If he works in the interest of management, it will be considered a fraudulent
case.

15. Leadership
The auditor must have the quality of leadership because he is the leader of audit team. He
should cooperate and coordinate with his staff to complete the work.

16. Ability to Plan
The auditor must be good planner. He should decide that which task is to complete in what
time.

17. Qualification
He must be a chartered accountant. According to companies’ ordinance and other related
national laws, it is essential qualification for auditor.

18. Secrecy
The nature of auditor’s work is very confidential. He should not disclose the affairs of his
client’s business to others.

19. Judgment
The auditor must have the quality of judgment in selecting the depreciation, provision for bad
debts and inventory valuation.

20. Diligent
The auditor should possess the quality of hard working. The job of an auditor is critical in
nature. It requires auditor’s time, energy, his personal attention and patience. Therefore, the
auditor should work diligently.
QUESTION # 18

Explain the special points to be kept in mind while examining the accounts of a Bank, Insurance, News Paper, Hotel, Textile, Sugar Mill, and Cement Factory.

ANSWER

SPECIAL POINTS IN AUDIT OF A BANK
During the audit of a bank following points should be kept in mind.

1. Loan and Advances
The auditor should verify the list of loans and advances with the ledger and also should see that loans and advances are properly secure or not.

2. Securities
The auditor should also examine the market value of securities which are held by bank against advancing the loan.

3. Balance with other banks
The auditor should verify the balance with State Bank of Pakistan and with other banks. He should obtain direct confirmation of balances from State Bank and other Banks.

4. Cash and Statutory Reserve
The auditor should see that bank has maintained the cash reserve and statutory reserve according to legal requirement.

5. Zakat and Ushar
The auditor should check the bank has deducted Zakat as required under Zakat and Ushar Ordinance 1980 and has deposited it into Central Zakat Fund.

SPECIAL POINTS IN AUDIT OF A INSURANCE COMPANY
During the audit of a insurance company the following points should be kept in mind.

1. Premium Received
Insurance company collects premium from policy holders. It is an amount that is paid by clients to cover risk of loss. It is an income for insurance company. The auditor should check premium received from policyholders.

2. Loan To Policyholders
The auditor should check the loans to the policy holders against Policies. The amount of loan should be under the surrender value of policy. The auditor should carefully verify that the loans are within the surrender value of policy.

3. Commission Payable
The auditor should verify the commission paid and payable to the agents. It can be verified by receipts voucher. He should also see that rate of commission is within the prescribed limits.

4. Annuities
The auditor should also see that all annuities paid and all annuities due but not paid are recorded in the books of the company.
5. Re-insurance
Sometime to reduce the risk of loss a company made re-insurance with another company. The auditor should check that the company has paid or receive reinsurance premium.

SPECIAL POINTS IN AUDIT OF A HOTEL
During the audit of a hotel the following points should be kept in mind.

1. Visitor Ledger
The auditor should carefully check the visitor’s ledger with cash book. He should see the amount charged from them.

2. Restaurant Bills
The restaurant bills can be checked to note sales of food and other items. The bills collected can be checked with proper entries in accounting books.

3. Purchases
Purchases of drinks and food materials are the main expenses. Auditor should carefully vouch the purchases.

4. Room Rental Income
It is the main source of income for hotels. Auditor should check the receipt book for income. He should also see the general occupancy rate for the year in particular location of hotels.

5. Car Rentals
Many hotels provide car facilities for their customers. Auditor should check receipts from rental and expenditures incurred on running and maintenance of vehicles.

SPECIAL POINTS IN AUDIT OF A NEWSPAPER COMPANY
During the audit of a newspaper company the following points should be kept in mind.

1. Advertisement Income
The auditor should check the advertisement income with the help of advertising day book and other evidence. He should also check the rates of advertisement.

2. Selling of old Edition
Sometimes there is a casual demand for old news editions. So he should verify the income from old newspapers.

3. Annual Subscription
Certain people buy newspapers on annual subscription basis. Newspapers companies offer special discounts to such people. So auditor should check the receipts of subscription and proper accounting treatment.

4. Printing Work
A newspaper company may print some other articles such as cards, magazines etc. the agreement for such printing must be checked.

5. Prize Money
The auditor should verify that whether any prize competition is offered by the company. He should see that proper amount for prizes has been made in the books of accounts or not.
SPECIAL POINTS IN AUDIT OF A TEXTILE COMPANY
During the audit of a textile company the following points should be kept in mind.

1. Material Consumed
The auditor should intelligently examine the total materials consumed in the production and the total amount of cloth produced. This examination will help the auditor to calculate the wastage and losses of material in production.

2. By Products
The waste of cotton can be used in production of by products. The auditor should ensure that there must be an effective internal control for sale and collection of by products. He should vouch the income of by products.

3. Verification of Stock
The auditor should check that the physical verification of the stock has been done by a responsible official. He should examine that the stock is valued at cost or market price whichever is less.

4. Verification of General Sales Tax
The products of textile mills are subject to sales tax. The auditor should check that sales tax has been calculated correctly and sales tax returns are submitted in time.

5. Unusual Items
If there is any unusual item such as sales of scrap, sale of old machinery etc. the auditor should check this item very carefully and intelligently.

SPECIAL POINTS IN AUDIT OF A CEMENT FACTORY
During the audit of a cement factory the following points should be kept in mind.

1. Quarry Rights
Limestone is the raw material for cement. All the cement factories hold long-term rights of quarries of limestone for which they pay royalty to government. The auditor should ensure that royalty has been paid according to the terms of lease deed.

2. Distributors’ Commission
The auditor should examine the terms of appointment of distributors or agents. He must ensure that commission is paid to agents or distributors according to the terms of their appointment.

3. Packing Cost
The auditor should check the cost of bag with reference to the contract made with the supplier of bags. The auditor should ensure that cost of bag must be included in production cost.

4. Contract with Vendors
The cement factory management can make agreement with vendors for sale of cement. Agreements made between management and vendors should be examined.
SPECIAL POINTS IN AUDIT OF A SUGAR MILLS
During the audit of a sugar mills the following points should be kept in mind.

1. Farming
The sugar mills may have its own agricultural farm to grow sugar cane. The auditor should vouch farm expenses and income. He should verify the sugarcane grown on company’s own farm and used in sugar mills. The auditor should also verify the farm assets and liabilities.

2. Advances to Farmers
Sometimes the sugar mills make advance payments to farmers to purchase more sugarcane. The auditor should verify that such advances are adjusted against the purchases of sugarcane.

3. Purchase of Sugarcane
The auditor should ensure that proper weighing arrangements are made for the purchase of sugarcane. The auditor should verify the transportation expenses paid to those farmers who supply sugarcane at the mills.

4. Packing Cost
The auditor should check the cost of bag with reference to the contract made with the supplier of bags. The auditor should ensure that cost of bag must be included in production cost.

5. By Products
The auditor must ensure that there should be an effective internal control for sale and collection of by products. He should vouch the income of by products.

Common points in various concerns

6. Investment:
The auditor should ask for the schedule of investment. He can see investment register. He can calculate the dividend received on such investment.

7. Minute Book:
Auditor should also examine the minute book and note down the resolution passed effecting the accounting and auditing matter.

8. Payment:
The auditor should verify the payment made to various parties. There should be proper authority for making payments. Auditor should carefully verify that the expenses are made only for business purpose.

9. Outstanding expenses:
The auditor should check expenses outstanding at the end of the year. The expenses due but not paid are to be recorded in the books of A/c. There is a need to check the calculation.

10. Receipts:
The auditor must check the receipts of cash from various sources. The goods sold or service provided may be the basis of cash receipts. There is a need to check the calculation of facts and figures.

11. Tax provision:
Auditor should see that adequate provision has been made by the company for tax payable and shown in the balance sheet.
12 Agreement:
The auditor should check the agreement between the parties. The terms and conditions of such agreement should be noted. The power of management should be examined from company article.

13 Nature of Audit:
In order to avoid misunderstanding between the auditor and client, a letter called audit engagement letter is written by auditor client clearly defining the auditor responsibilities. Auditor should receive engagement letter.

14. copy of resolution:
The copy of resolution of director or shareholders can be obtained from the company secretary. The decision takes by the management should be implemented. The decision can be check in the books of account.

15. Contingent liabilities:
The auditor must check the contingent liabilities have been properly disclosed in the final accounts.

16. Maintenance of Depreciation:
The auditor should examine the depreciation charged on various assets. The rate of depreciation can be checked. The principal of consistency should be applied for depreciation matter.

17. Make sure from report:
Auditor should study audit report of previous year audit and if any qualification are found in it then special attention should be given to these qualification.

18. Observe Capital and Revenue:
The auditor should examine that proper distinction has been made between capital and revenue expenditure. The true and fair view of financial statement is possible due to proper allocation between capital and revenue expenditure.

19. Prepaid Expenses:
The expenses may be paid in advance. There is a need of adjustments at end of accounting period. Auditor should carefully check that the adjustments have been made or not

20. verification of closing stock:
The auditor should observe & verify the closing stock of the company. Stock should be valued at lower of cost or market value. The auditor should checked it at the end of the year.

21. Intangible Assets:
Intangible assets e.g. goodwill, patents, copyright etc. are recorded at cost less amortization. Auditor should check that proper amortization has been recorded or not.

22. Nature of Accrued income:
The auditor should note the income earned but not received. He should check the adjusting entries made in the books of accounts. It is essential for determining the profit & loss for the year
QUESTION # 19

Discuss the Auditor’s liabilities towards his client with relevant case laws. (2014)

OR

Briefly explain the following liabilities of an auditor along with case references (2012)

(a) Negligence
(b) Misfeasance
(c) Criminal liability
(d) Liable
(e) Third Party

LIABILITY FOR NEGLIGENCE

Meanings:
“Negligence means not properly taking care in the performance of duties.”

Explanation:
An auditor to a limited company is an agent of shareholders. He is required to exercise reasonable care and skill in the performance of work entitled to him. If auditor fails to do his work honestly then he may be held liable for the negligence.

Legal rules:
Legal provisions regarding auditors’ liability for negligence are as under:-

1. No Suffering of loss:
Where the auditor is proved to be negligent but no loss is sustained by his client due to his negligence, he is not liable.

2. Suffering of loss
If auditor is proved negligent in the performance of his duties then he is liable to make good any loss caused by his negligence to others.

3. No restriction of liability
An auditor cannot restrict his liability by entering into an agreement as his duties are defined & laid down in Company Ordinance 1984. Any such agreement would be against the law and will be void.

4. No relief from liability
No clause in AOA of company can relieve the auditor of his liability according to sec 194 of Company Ordinance 1984.

5. Action against auditor
Action against the auditor for negligence can be taken any time during the life time of the company.
Legal cases:

1. Kingston cotton mills Co. Ltd (1896)

Fact of the Case
Auditor of the company was sued for negligence because he relied upon the stock sheets which was prepared by the company staff and signed by manager.

Plaintiff’s Plea
Auditor defended himself by saying that he relied upon stock sheet while signing the Balance sheet because the stock sheet is approved by “manager’s certificate”.

Court Decision
The court relieved the auditor by saying that he was right while accepting the certificate of the company.

2. London oil storage Co Vs Seear hasluck & Co. (1904):

Facts of case:
Actual petty cash in hand was only £ 30 and the petty cash balance was shown in the books at £ 796 and the difference of £ 766 was misappropriated by petty cashier.

Defendant Plea:
The auditor said that there was negligence on the part of the directors who kept a large sum of money with petty cashier and hence misappropriation occurs.

Court Decision:
The court gave the judgment that main party to negligence was directors not auditors. So main loss is to be compensated by the directors and auditors were relieved with the nominal damages only.

LIABILITY FOR MISFEASANCE

Meanings
Misfeasance means wrong performance of a lawful work. In audit misfeasance means breach of duty.

Explanation
It is the duty of auditor to obtain all information and explanation as required for audit purpose. After audit he should express his opinion as to the truth and fairness of financial statements. If auditor is unable to collect necessary information and as a result not express correct opinion about financial statements then he will be liable for misfeasance. This liability arises in time of winding up of the company.

Action can be taken by

1. The liquidator
2. A Creditor
3. A contributory of the company (shareholders).
**Time period for proceedings:**
Misfeasance application may be submitted to the court within 5 years from the date of the order of winding up or appointment of liquidator.

**Legal cases:**

1. Westminster Road Construction Engineering Co. Limited (1932)

**Facts of case:**
In this case the auditor was failed to disclose that work in progress was overstated and the liabilities were understated. Hence the profit was shown as 3458 pounds while actually was 297 pounds. Due to this, dividend was paid out of capital.

**Plaintiff’s Plea**
Shareholders said that many invoices were remained unchecked by the auditor. So he is guilty of breach of duties.

**Court Decision**
The auditor was ordered to pay the amount of dividend with interest.

2. Wild & others VS. Cape and Dalgleish (1897)

**Fact of Case**
Auditor has not checked the passbook while doing the audit and cashier embezzled 1750. Firm filled a suit for negligence as well as for breach of duty.

**Defendant’s Plea**
Auditor said that his duties were consisted of reporting on profit and loss account and balance sheet so he should be relieved from charge.

**Court Decision**
It was decided that although loss is more but all the liability does not belong to auditor.

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**LIABILITY FOR LIBEL**

**Meaning:**
Auditor’s liability for libel (defamation) arises when his report containing criticism and defamation (insult) of officers and other staff of company.

**Explanation:**
It is the duty of auditor to report on actual financial position of company but he must not have blaming & defaming attitude during audit or in reporting. Professional code of conduct requires audit from auditor to act as neutral charge between two parties.

- Management
- Shareholders.

**Legal Provisions:**
But to hold an auditor liable for libel it will be required to prove that the report submitted by the auditor is
(i) Mis-stating the Facts
It should be proved that the facts given by auditors are not true.

(ii) Actuated by Malice:
The report is written by malice (hate).

(iii) Irrelevant Subject
The activities carried out by the auditor are beyond the scope of duty or the comments the auditor has so passed were not within his scope.

(iv) Not Bonafide
The statement made in audit report is not bonafide.

Case Law

1. Lawless VS. The Anglo- Egyptian Cotton and Oil Company Limited (1869)

Facts of the Case
The fact of the case was that there was a head office of the company in Manchester and branch in Egypt. Branch manager in Egypt rendered account of branch to head office in which there was a deficiency of stock £ 1306. When branch manager was asked he explained that it is not deficiency but a depreciation of stock.

The auditor of the company was not satisfied with the explanation and his report contained the following comments.

“The shareholders will observe that there is a charge for £ 1306 for deficiency of stock for which the manager is responsible. His accounts have been badly kept, and have been rendered to us very irregularly”.

The directors after getting the said report printed and circulated to the shareholders.

Plaintiff’s Plea
The manager pleaded that auditor’s comments in his report injured his reputation. He blamed directors of the company that why they circulated such statement of defamation to shareholders.

Defendant’s Plea
The company defended the case by saying that it is the regular practice of auditor to report what he observed and duty of the directors to circulate such report to the shareholders.

Court Decision
It was found that there was no evidence of malice, so auditors and directors were not held liable for libel.

2. Weld Blundel VS. Stephen (1920)

Facts of the Case
The facts of the case were that Mr. Weld Blundel was interested to purchase a business. He appointed Mr. Stephen (auditor) for investigation. In the course of investigation Mr. Weld Blundel wrote a letter of instructions which contained defamatory matter relating to two individuals connected with the management of the company. Stephen’s partner, lost the letter
when he went for presentation to management. The contents of the letter came into the knowledge of two individuals. They sued Mr. Weld Blundel for libel and Mr. Weld Blundel sued Stephen (auditor).

**Plaintiff’s Plea**
Mr. weld Blundel pleaded that auditor neglected his duty so he is liable for libel.

**Defendant’s Plea**
Mr. Stephen pleaded that his partner lost the letter containing the remarks of two individuals un-intentionally, so he is not liable for libel.

**Court Decision**
Learned judge gave the decision in favour of Mr. Weld Blundel and held the auditor guilty, damages of £ 650 and cost of prosecution were ordered to be paid.

**LIABILITY TO THIRD PARTY**

The auditor is an agent of his client, therefore, the auditor is liable for damages if his client suffers loss due to his negligence. However, there are third parties for example bankers, tax authorities, insurance company, supplier, investors, customers etc. who may suffer loss by relying upon the audited financial statements. The question is whether the auditor is liable, if the third party rely on the audited financial statements and suffers a loss. Auditor will be liable to third party if third party prove the following facts.

(a) **Untrue Balance Sheet**
The third party has to prove that the statement or balance sheet signed by the auditor was untrue.

(b) **Known to auditor**
That the auditor knew that the statements were untrue.

(c) **Intention to Acts**
That the statements etc., were made with an intent that a third party should act on it.

(d) **Acted and Suffered**
That the third party did act upon such statement etc. and suffered loss as a result of reliance on it.

**Legal Cases:**

1. **Ultramares Corporation VS. Touche Niven and Company**

**Facts of the case**
Facts of the case were that a banker advanced money to Fred Stern & Co. on the strength of the audited balance sheet. The lender lost the money as the balance sheet showed the company to be financially sound but in fact it was insolvent.

**Plaintiff’s Plea**
The lender bank sued the auditor for damages because the auditor through negligence had failed to discover falsification.

**Defendant’s Plea**
The auditor pleaded that he had never been appointed by the lender bank to examine the accounts of borrower, so he cannot be held liable to lender bank.
**Court Decision**
The case was compromised between the parties because the auditor did not know that accounts will be used for what purpose.


**Facts of the case**
Facts of the case were that managing director of the company was getting loan from bank. Bank relied on auditor’s statement showing the profit of £14000, but with wrong estimation regarding stock. Managing director himself used the audited information and suffered losses.

**Plaintiff’s Plea**
Managing director sued auditor for damages because he made the investment relying on audited accounts and suffered loss.

**Defendant’s Plea**
The auditor pleaded that he had no contract with the managing director and consequently he has nothing to do with him.

**Court Decision**
While declaring the judgment, it was held that auditor is not liable to managing director.

**CRIMINAL LIABILITY**

**Meanings**
Crime means any offence punishable by law. In auditing the criminal liability of auditor arises when he intentionally certifies wrong accounts and statements with the intention of misleading or deceiving other people.

**Explanation**
Criminal liability of an auditor basically arises because of offences against the statutory provisions. For a criminal act, an auditor may be held responsible not only to the shareholders but also to other people who rely on them. The injured party can go to the court against auditors. Court may decide the matter in the following manner:

- There may be imprisonment for a number of years
- A fine may be imposed on the auditors
- He may be fines and may face imprisonment also.

**Legal Provisions**
Following are the different provisions in companies’ ordinance regarding the criminal liability.

**Mis-statement in Prospectus**
An auditor may be liable to fine up to Rs. 10,000 or with imprisonment for a term, which may extend to 2 years if the prospectus includes any untrue statement.

**Known False Statement**
If the auditor makes a false statement knowingly to induce other persons to invest money in a company, he shall be liable for imprisonment, which may extend to 3 years or with fine which may extend to Rs. 20,000 or both.
**Disqualified Appointment**
If an auditor who is not qualified to be an auditor of a company act as auditor of the company shall be liable to fine which may extend to Rs. 25000.

**Audited Accounts**
If the audited accounts and statements and auditor’s report not submitted within two months of the end of the period or within extended time period shall be fine up to Rs. 5000.

**Legal Case**

1. **Karachi Bank Limited VS. Directors, Manager and Auditor (1932)**

   **Facts of the case**
The fact of the case were that the directors showed a cash profit by adding dad and doubtful debts. The auditor certified the accounts. This false statement was made in the balance sheet.

   **Plaintiff’s Plea**
The shareholders of the company pleaded that auditor willfully made a false statement with the intention of deceiving them.

   **Defendant’s Plea**
The auditor argued that he signed the balance sheet drawn in conformity with law relying upon the responsibility of the bank.

   **Court Decision**
While delivering judgment the justice held the auditor liable for willfully making a false statement in the balance sheet as well as in his report.

2. **Dumbell’s Banking Company Limited (1900)**

   **Facts of the case**
The fact of the case were that Dumbell’s Banking Company issued balance sheet in which an amount of £ 65000 due from London City and Midland Bank Ltd. was shown under the head “Cash in hand”. The auditor of the bank informed the bank management about this error, but the bank management presented balance sheet as it was. The auditor presented the false balance sheet to the shareholders.

   **Plaintiff’s Plea**
It was pleaded on behalf of the shareholders that auditor was involved in issuing false balance sheet with the intention to deceive the shareholders.

   **Defendant’s Plea**
The auditor argued that he had intimated the management about the charge of amount to wrong head, therefore, he should not be held liable for that.

   **Court Decision**
While delivering judgment auditor and directors both were held criminally liable on the plea that a concealment of fraud can be treated as assistance to fraud.
QUESTION # 20

Define Vouching? What are the techniques or principles of vouching? (2014)

ANSWER

VOUCHING
Vouching means the examination of every business transaction with its supporting documentary evidence. Vouching enables the auditor to satisfy himself that the transactions have been correctly entered in the books of accounts.

According to Lawrence R. Dicksee
“Vouching consists in comparing entries in the books of accounts with documentary evidence in support thereto.”

PRINCIPLES or TECHNIQUES OF VOUCHING
Following are the main points of conducting vouching.

1. Arranged Voucher
Vouchers are the basis of entry in the books of accounts. The vouchers should be consecutively numbered and filed in order of entire, appearing in the books of accounts. If vouchers are not properly arranged, valuable time of the auditor will be wasted in finding out a particular voucher.

2. Properly Dated
The auditor should check that each voucher must be dated. The date of voucher must correspond with the books of accounts. Without date no voucher should be accepted.

3. Related to Business
Special attention should be given to check that voucher must be related to the business. The voucher in the personal name of partners or directors or managers or secretary, etc. may not relate to business and are not acceptable.

4. Related to the Period
The auditor should check that the voucher are related to the period under audit.

5. Amount of Voucher
The amount of voucher should be calculated accurately. The amount of voucher should agree both in words and figures.

6. Signature
Every voucher should bear the signature of responsible official. The auditor must check the signature of a competent person on voucher. Without signature the voucher may be considered as doubtful.

7. Paid and Cancelled
The vouchers paid should be stamped “Paid and Cancelled”. If the stamp is not available, the auditor should put a tick mark across the face of the voucher.
8. Period of Payment
While checking the voucher for payment of insurance premium, rent, taxes etc., the auditor must check the period for which payment has been made. If the payments are made in advance, the auditor should see that adjustment has been made.

9. Properly Recorded
The auditor must check that vouchers are properly recorded in the books of accounts and proper distinction is made between capital and revenue items.

10. Missing Voucher
In case of missing voucher the auditor must ask for the reason. He may ask the client to obtain a duplicate copy from the supplier.

11. Client Staff
The auditor should not seek the help of client’s staff while checking vouchers.

12. Alteration
Any alteration or cutting in date, rate or amount on voucher must be fully enquired into. Such vouchers should not be accepted unless signed by any senior and responsible official of the organization.

13. Use of Tick Mark
After checking the voucher, the auditor should mark a tick on it. These ticks should be different from ticks marked by internal auditor.

14. Further Explanation
The auditor should prepare a list of all vouchers that require further explanation from the client’s staff. If the client’s staff fail to provide satisfactory answer, the auditor should mention this fact in its report.
QUESTION # 21

Define verification. Discuss in detail the Techniques of verification? (2010, 12)

ANSWER

VERIFICATION

Verification is a procedure of confirming existence, ownership, possession of assets and liabilities. The duty of auditor is not only to examine the arithmetic accuracy of the transactions by vouching but also to verify assets and liabilities appearing in the balance sheet.

According to Spicer and Pegler

“Verification of assets involves an enquiry into the value, ownership and title, existence and possession, the presence of any charge on the assets.”

So Verification of Assets may be said to form an opinion in respect of the following:

1. Existence of the Assets
2. Ownership of Assets
3. Possession of the Assets
4. Proper valuation of the Assets
5. Proper presentation

Verification of Liabilities:

1. Balances in Creditors,
2. All liabilities have been disclosed.
3. All liabilities are properly valued.
4. Proper classification of Liabilities.

PRINCIPLES or TECHNIQUES OF VERIFICATION

Following rules can be followed for the verification of assets and liabilities appearing in balance sheet.

1. Physical Existence
   Physical existence of an item can be verified by following two ways,

   (i) An item may be physically verified by actual count or measurement or weighing.

   (ii) Where the 1st technique is not possible to apply, then the existence of items may be verified by documentary evidence duly signed by a responsible person.

2. Proper Valuation
   According to GAAP different methods are adopted for valuation of fixed and current assets. Auditor should verify that the assets are recorded according to correct method or not. A brief description of these methods is given below.

   (i) Fixed Asset
   Fixed assets are valued at cost less depreciation.
(ii) **Current Asset**
Current assets are as a general rule, valued at cost or market price, whichever is less at the date of balance sheet.

(iii) **Intangible Assets**
Intangible assets such as goodwill, trade mark, copyrights, patents etc. are valued at cost less amortization.

3. **Ownership**
It is necessary for the auditor to satisfy himself about the ownership of the asset. Ownership of assets can be verified by examining different types of documents.

4. **Verification of Charge**
When loan is taken the assets are transferred in the name of the lender as security. These assets are said to be under charge. It is the duty of auditor to verify whether the asset is under charge or not. Following steps will enable the auditor to find out whether an asset is under charge or not.

   (i) The auditor must obtain a certificate from the management regarding the charge on fixed asset.

   (ii) The auditor should enquire from lender the nature of charge established against asset.

   (iii) The auditor should examine the register of mortgage and charge.

5. **Proper Authorization**
In the process of verification of assets and liabilities, the auditor has to satisfy himself that the acquisition and disposal of the assets and liabilities is properly authorized. The auditors generally require, minutes of the meeting of board of directors for any addition or deletion in the fixed asset.

6. **Proper Disclosure**
The auditor must ensure that all information regarding assets and liabilities has been properly disclosed in balance sheet as required by law.
Define “Investigation. What are the techniques of investigation?

**INVESTIGATION**

Investigation means an enquiry into the accounts of a business for a special purpose. It is a kind of special audit. Investigation may be conducted for many objectives such as to ascertain the normal earning capacity of the organization or the detection of fraud. The examination under investigation is more intensive and comprehensive than the one under audit.

**According to Spicer and Pegler**

“The term investigation implies (involves) an examination of accounting records for some special purpose”.

**TECHNIQUES OF INVESTIGATION**

Exact techniques and procedures to be followed by an investigator entirely depend upon the nature and objective of investigation. Generally the investigator should observe the following techniques and guidelines while conducting investigation.

1. **Purpose**

The investigator should ask the client, the purpose of investigation. The investigator should prepare investigation programme keeping in view the purpose of investigation.

2. **Instructions**

The investigator should obtain in writing clear instructions from the interested party regarding the following points.

   (a) Period for which investigation has to be conducted.

   (b) The person to whom the investigator may approach for any information.

3. **Intimation to Auditor**

If investigator is other than the auditor, then the investigator should intimate to the auditor of the organization about the intended investigation. This intimation will be helpful for the investigator in getting assistance, if required, from the auditor.

4. **Preliminary Arrangement**

The investigator should prepare a list of all items of information to be collected, the accounting and other records to be examined for the purpose of investigation. The investigator should contact the responsible person who can provide the necessary information.

5. **Sufficient Staff**

The investigator should determine the number of staff required to complete the investigation. The number of staff required will depend upon the nature and objective of investigation, the time period, etc.

6. **Preparation of Investigation Programme**

The investigator should prepare an investigation programme like an audit programme. Investigation programme is devised separately for each investigation. The investigation programme is prepared keeping in view the nature and objective of each investigation.
7. General Information
The investigator should collect the following information regarding the business to be investigated:
   (a) Nature of the business
   (b) Products of business
   (c) Number of employees
   (d) Size of sales order and share in the market

8. Collection of Evidence
The investigator should collect evidence from internal and external sources. The books of account and other records can provide maximum evidences about investigation. The external sources for collection of evidence are banks, customers, suppliers etc.

9. Enquiry About Staff
The investigator should make an enquiry into the character of the staff of the organization being investigated. This will help the investigator to complete the enquiry effectively and satisfactorily.

10. Consultation with Experts
The investigator should not completely depend upon the evidences collected and the audited accounts of the organization under investigation. Where it is desired, he should consult the valuers, surveyors and other technical experts to have their technical opinion.

11. Act Independently
The investigator should conduct investigation independently with reasonable care and skill. He should be honest and must not be influenced by any interested party. The investigator should be impartial.

12. Working Papers
The investigator should prepare his working papers carefully. The working papers should contain complete record of procedures adopted, evidences collected, enquiries made, explanation received and other relevant matters, to finalize report.

13. Findings
The investigator must arrive at the findings on the basis of investigation conducted. He should draw the right conclusion keeping in view the objective of investigation.

14. Report Outline
The auditor should prepare an outline of report. The most important matters should be recorded first. There should be sequence of ideas to be presented in report.

15. Preparation of Report
Finally, the investigator should prepare investigation report for the interested party. There is no standard format of investigation report. However, most of the investigation reports include the following points.
   (a) Purpose of the investigation
   (b) A statement of work done
   (c) A statement of results obtained, supported by facts and figures
   (d) A statement of conclusions reached

Investigation report should be written in such a style and language as is not interpretable to several meanings.
16. Submission of Investigation Report
The investigation report should be submitted to the interested party before or on due date fixed by the interested party, so that relevant correct conclusion may be drawn and action initiated accordingly.

QUESTION # 23: Define “Investigation”. How does it differ from Audit? (2011)

INVESTIGATION
According to Spicer and Pegler
“The term investigation implies (involves) an examination of accounting records for some special purpose”.

Explanation:
Investigation means an enquiry into the accounts of a business for a special purpose. It is a kind of special audit. Investigation may be conducted for many objectives such as to ascertain the normal earning capacity of the organization or the detection of fraud. The examination under investigation is more intensive and comprehensive than the one under audit.

DIFFERENCE BETWEEN AUDIT AND INVESTIGAITON
The difference between audit and investigation can be summarized as under:

1. Scope
   (a) The scope of audit is broader than that of investigation
   (b) The scope of investigation is limited

2. Determination of Scope
   (a) The scope of statutory audit of a Public Ltd. Co. is determined by the Pakistan Companies ordinance, 1984.
   (b) The scope of investigation is determined by the investigator keeping in view the objective of investigation.

3. Nature
   (a) Audit is a kind of test checking for the whole accounting period.
   (b) Investigation is a thorough examination of the books of account for a particular period.

4. For Whom Conducted
   (a) Audit is conducted for shareholders
   (b) Investigation is conducted for shareholders or partners or outsiders.

5. Compulsory
   (a) Audit is compulsory for public limited company.
   (b) Investigation is not compulsory for any organization

6. Duplication
   (a) Audited accounts are not audited again.
   (b) Investigation of same matter can be repeated.

7. Possibility of re-occurrence
   (a) Audited accounts may further be investigated
   (b) Generally investigated accounts are not audited.
8. Examination
(a) Audit is an examination of accounting records of an organization
(b) Investigation is not only an examination of accounting records but also an enquiry into other facts.

9. Qualification
(a) The auditor must be a chartered accountant
(b) The investigator may or may not be a chartered accountant

10. Rights and Duties
(a) The rights and duties of an auditor are determined by relevant law
(b) The rights and duties of an investigator are determined by investigator and client

11. Status
(a) The auditor cannot be an employee of the organization
(b) Investigator may be an employee of the organization

12. Sequence of work
(a) Audit is generally conducted before investigation
(b) Investigation is generally conducted when audit has already been done.

13. Work Programme
(a) In an audit the work programme is generally determined
(b) It is not possible to provide a structure work programme for an investigation

14. Accounting Policies
(a) The auditor has to state whether the accounting policy of the organization has been followed or not.
(b) Investigation has no concern with the accounting policy of the organization

15. Rearranging data
(a) The auditor cannot rearrange the existing data
(b) The investigator may rearrange the existing data, redraft the accounts for a particular view point.

16. Regular
(a) The auditing is a regular feature of the organization
(b) Investigation is not regular feature of the organization

17. Disclosure
(a) The audit requires full disclosure of information under law
(b) There is no legal requirement to disclose investigation information

18. Adjustment
(a) The auditor cannot make any adjustment in the books of accounts.
(b) The investigator can make necessary adjustment in the books of account.

19. Recommendation
(a) The auditor has no right to give recommendation
(b) The investigator can recommend the course of action to overcome the deficiencies.
Principles of Auditing

20. Evidence
(a) Audit report is a legal document. It can be used as in evidence
(b) The investigation report is a personal document, it cannot be used as an evidence.

QUESTIN # 24

What is audit programme? Give its advantages and disadvantages. (2014)

ANSWER

AUDIT PROGRAMME
Before the commencement of audit, the auditor should prepare the audit programme. Audit programme is a written scheme of audit work. In audit programme the audit work is divided into different parts. It point out the work which the audit team has to carry out in during audit.

According to Holmes
“An audit programme is a flexible planned procedure of examination of accounting records.”

ADVANTAGES OF AUDIT PROGRAMME
The main advantages of audit programme are as under.

1. No Omission
The audit programme ensures that all necessary audit work has been done and nothing has been omitted. In the presence of audit programme the audit work proceeds in a regular and systematic manner.

2. Progress of audit work
Audit programme is useful to check the progress of audit. The auditor can know the progress of audit work. He is in a position to know that how much audit work has been completed.

3. Fixing of Responsibility
Audit programme helps to fix the responsibility of the audit work done by different audit clerks if any discrepancy is found at later stage.

4. Transfer of audit work
If any audit clerk goes on leave or resigns in the middle of audit work, the audit work can easily be transferred to new audit clerk. By studying the audit programme, the new audit clerk can pick up the thread of work from the stage where the previous clerk had left.

5. Legal Proof of work Done
Audit programme is a legal proof of the audit work done by members of audit team. If at any time suit is brought against the auditor for alleging negligence in audit work, then the audit programme serves a good evidence for the audit work performed by auditor and his staff.

6. No Repetition
In the presence of audit programme the audit work proceeds in a systematic manner. The audit clerks know that audit work done by them, so unnecessary repetition is avoided.

7. Uniformity in Work
Uniformity in audit work can be ensured as the audit programme for one period can be adopted as the basis for the subsequent period.
8. **Effective Control**
Audit programme helps to maintain effective control on the progress of several audits at the same time. The principal auditor being sitting in the head office can easily control the audit work.

9. **Division of Work**
In the presence of audit programme, the audit work can easily be divided among various audit clerks according to their abilities and experience.

10. **Important Points**
The audit programme ensures that all important points have been given proper attention in audit. There are no chances of being overlooked any point.

11. **Training Tool**
Audit programme is a training tool. It provides training to new audit clerks. They can learn how to perform the audit work.

12. **Audit Staff Requirement**
Audit programme helps the principal auditor to determine the number of audit clerks required to complete the audit work within prescribed time.

13. **Clear Cut Instructions**
Audit programme provides the audit staff with clear cut instructions about the audit work to be performed.

14. **Guidance**
Audit programme serves as guideline to new audit clerks for the audit work they have to perform.

15. **Increase in efficiency**
The audit staff knows that their activities are being watched with the help of audit programme. They work with great care and their efficiency is increased.

**DISADVANTAGES OF AUDIT PROGRAMME**
Following are some important disadvantages of audit programme

1. **Mechanical**
Audit programme gives the audit staff main direction of work. As a result, the work becomes mechanical and some portion of audit work completed without proper attention.

2. **Not always suitable**
Each organization has separate problems of its own. A rigid audit programme may not be suitable for each type of organization.

3. **Extra Activity**
Audit programme can save time of audit in large business units. Whereas in small business units, the transactions are very few, so auditor’s planning in the form of audit programme is an extra activity for auditor.
4. No Suggestion
Another drawback of audit programme is that the efficient audit clerk loses his initiative because he has to work strictly according to audit programme. He cannot make any suggestion to overcome the deficiencies of audit programme.

5. Protection to inefficient staff
Audit programme protects the inefficient audit staff. The deficiencies in audit work can be defended on the plea that no specific instructions in the matter were contained therein.

6. No detection of errors and frauds
With the help of audit programme, the accounting staff know that which, when and what is going to be audited. They can devise means to record the transactions in such a way as to escape detection of errors and frauds.

7. Overlooks New Matters
New important matters arising between one period and another may be overlooked because audit programme is not revised every year.

8. Loses sense of responsibility
Audit programme may lose sense of responsibility of audit staff as they do not work independently.

9. Not Comprehensive
Audit programme cannot cover every point that might come up during the course of audit, even if it is well drawn.
QUESTION # 25

What is annual report? Explain their contents and give specimens.
OR
What are qualified and unqualified audit reports. Also explain their contents and give specimens.

OR

Define the term un-qualified and qualified report. Discuss the audit work involved in submission of audit report. Give specimen of such report?

ANSWER

AUDIT REPORT

“End product of an audit is the auditor’s report. The auditor report summarizes results of the work conducted by the auditor and formally communicates the auditor’s opinion”.

ANNUAL AUDIT REPORT

The directors of every company are required to place in the annual general meeting, the balance sheet, profit & loss Account and statement of changes in financial position duly audited by the external auditor of the company. The auditor after verification give a report that whether financial statement are giving true and fair view of the state of the affairs of the company such report is called Annual Audit Report.

Annual audit reports are normally of two types.

1 Un-Qualified Report.
2 Qualified Report

Un-Qualified / Clean / Positive Report

“An audit report which contains no reservations or objections is called unqualified report”.

When the auditor is fully satisfied about the accounting record, legal requirements, auditing standards and with the performance of the management, he submits a report which is called unqualified report. Unquailed report is issued when the accounts exhibit a true and fair view of the financial affairs of the company. An unqualified report is also called positive report or clean report.

CONTENTS OF UNQUALIFIED REPORT

According to companies ordinance 1984 following are the contents of unqualified report.

1. All information and explanations obtained
In an unqualified report, the auditor declares that he has obtained all information and explanations which to the best of his knowledge and belief were necessary for the purpose of audit.

2. Proper Books of Accounts
In an unqualified report, the auditor declares that proper books of account according to the requirements of the Companies Ordinance 1984 have been kept by the company.
3. Financial Statements as per the Ordinance
The auditor issues unqualified audit report, where in his opinion the balance sheet and profit and loss account or income statement have been drawn in conformity with the Companies Ordinance 1984.

4. Financial Statement agree with accounts
In an unqualified report the auditor declares that financial statements are in agreement with the books of account and also in accordance with the accounting policies consistently applied.

5. Expenditure for the purpose of Business
In an unqualified report, the auditor gives his opinion that the expenditures incurred during the year are for the purpose of business of the company. It means that the auditor should confirm that all expenses related to the business.

6. Investments and expenditures meeting company objectives
In an unqualified or positive report the auditor gives his views that the business conducted, investments made and expenditures incurred during the year were in accordance with the objectives of the company.

7. Financial Statements give true and fair view
The auditor submits an unqualified report when he is satisfied that the financial statements give the true and fair view of the company’s affairs and financial position.

8. Deduction of Zakat
A clean or unqualified report is issued by the auditor when in his opinion, zakat deductible at source under the Zakat and Usher Ordinance, 1980 was deducted by the company and deposited in the Central Zakat Fund.

SPECIMEN OF AN UNQUALIFIED AUDIT REPORT

Auditors’ Report to the Members
We have audited annexed balance sheet of XYZ Limited as at 31st December 2013 and the related profit & loss account and statement of changes in equity and cash flow statements together with notes.

We state that we have obtained all necessary information and explanation after due verification we report that.

(a) In our opinion proper books of accounts have been kept by the company as required by the companies ordinance 1984.

(b) In our opinion:

(1) The balance sheet and profit & loss account with the notes have been drawn in conformity with ordinance 1984.

(2) The expenditure incurred during the year was for the purpose of the company’s business.

(3) The business conducted, investment made the expenditure incurred during the year were in accordance with the object of the company.
Principles of Auditing

(c) In our opinion and the best of our information and according to explanation given to us. The balance sheet, profit & loss account, statement of changes in equity and cash flow statement together with the notes give true and fair view of the company’s affairs.

(d) In our opinion Zakat deductible at source under the Zakat and Usher ordinance, 1980 was deducted and deposited in the Central Zakat Fund.

ABC Company
Chartered Accountant
Date …………………

QUALIFIED REPORT
“An audit report that contains objections and reservations is called qualified report”

Whenever the auditor of the company is not satisfied with any explanation and information provided to him or if he thinks that profit and loss account an balance sheet do not exhibit a true and fair view of the affairs of the company, he submits a qualified report. In qualified report the auditor explains the errors, irregularities and complaints of the business.

CONTENTS OF QUALIFIED AUDIT REPORT
According to companies ordinance 1984 following are the contents of qualified report.

1. **No proper books of account**
The Companies ordinance, 1984, describes the books which have to be maintained. If proper books of accounts have not been maintained, the auditor submits qualified report.

2. **Informal Statements**
The format of statements to be prepared by the company has been given in the Companies Ordinance, 1984. If the company does not prepare the statements in the prescribed format, the qualified report is issued.

3. **Disagreement**
The figures of financial statement must agree with the figures recorded in the books of account. If there is difference in figures, then the qualified report will be issued.

4. **Incorrect Allocation**
If capital items have been treated as revenue items or vice versa, to give undue benefit to management, such errors may lead to qualified opinion of auditor.

5. **Changes in Accounting Principles**
If there is a change in the accounting principles and the management is unable to explain the satisfactory reason of this change, the qualified report will be issued. For example, change in depreciation rate of fixed asset, etc.

6. **No Satisfactory Evidence**
If some transactions are recorded in the books of accounts and the auditor is unable to obtain satisfactory evidence for these transactions, the qualified report will be submitted.

7. **Business Conducted Not in Accordance with Objectives**
If business conducted, investment made and the expenditure incurred during the year are not in accordance with the objectives of the company, it will lead to qualified report.
8. No Access to Books
If the management refuses the auditor to have access to the books of accounts and other relevant records, the auditor will present the qualified report to the shareholders.

9. Information and explanation
If the auditor has not been supplied complete information and explanations for the purpose of audit, he will submit qualified report.

10. Not Independent
If the auditor is not independent in performing his duties, he can submit qualified audit report.

11. Inappropriate Accounting Method
If inappropriate accounting methods are used then qualified report will be issued by auditor. Following are examples of inappropriate accounting method.

(a) No depreciation has been provided
(b) No provision is provided for bad debts
(c) Investment and stock has been valued at cost which is higher the market price.

12. No Zakat Deduction
Either no Zakat deduction arrangement is made or insufficient amount of Zakat is deducted.

SPECIMEN OF QUALIFIED REPORT

Auditor Report to the Members
We have audited annexed balance sheet of XYZ Limited as at 31st December 2013 and the related profit & loss account and statement of changes in equity and cash flow statements together with notes.

We state that we have obtained all necessary information and explanation after due verification we report that.

1. Company has not provided depreciation amounting Rs.50000.
2. Provision for taxation Rs. 20,000 was not provided for.
3. Payable salaries Rs. 50,000 are not disclosed.

Except for the above we state that:-

(a) In our opinion proper books of accounts have been kept by the company as required by the companies’ ordinance 1984.

(b) In our opinion:

(1)The balance sheet and profit & loss account with the notes have been drawn in conformity with ordinance 1984.

(2)The expenditure incurred during the year was for the purpose of the company’s business.

(3)The business conducted, investment made the expenditure incurred during the year were in accordance with the object of the company.
(e) In our opinion and the best of our information and according to explanation given to us. The balance sheet, profit & loss account, statement of changes in equity and cash flow statement together with the notes give true and fair view of the company’s affairs.

(d) In our opinion Zakat deductible at source under the Zakat and Usher ordinance, 1980 was deducted by zakat ordinance under section 7.

ABC Company
Chartered Accountant
Date ..................
QUESTION # 26

As an auditor discuss your duties regarding statutory report. Give specimen of such report?

Introduction:
The companies are required to conduct the statutory meeting within 3 to 6 month after getting certificate of commencement of business. In such a meeting the director are to forward a report to every member of the company at least 21st days before the date of the statutory meeting this report is called statutory report.

It is the duty of the auditor of the company to certify the correctness of the information given by the statutory report regarding:

(i) Shares allotted.
(ii) Cash received against such allotment.
(iii) Receipts & payment of the company.

Contents of statutory report
Some important contents of statutory report are as under.

(1) The total number of shares allotted.
(2) The total amount of cash received by the company in respect of shares allotted.
(3) Names and addresses of the directors, auditors and of the secretary of the company.
(4) The particulars of underwriting contracts, if any
(5) An account of preliminary expenses of the company
(6) The detail of any commission or brokerage paid in respect of issue of shares.
(7) Auditor’s certificate regarding correctness of statutory report.

Auditor’s duties as to certification of statutory report
The work done by an auditor in respect of the certification of statutory report is called “Statutory Audit”. The auditor should confirm the accuracy of contents of report by examination and vouching the relevant documentary evidence. Work involved in this regard is as follow.

1: Certification of share allotted
For the certification of correctness of shares allotted, the auditor is required to perform the following work.

(i) Issued Capital
The auditor should ensure that issued capital should be within the limits of authorized capital and according to the prospectus and resolution passed in the board of directors’ meetings.

(ii) Consent
The auditor should examine that the shares have been issued according to the prior consent of Securities and Exchange Commission of Pakistan.

(iii) Allotment of Shares
A meeting of the board of directors is held for the allotment of shares. If the shares have been oversubscribed, the shares are allotted according to decision of board of directors. The auditor should examine the minutes of the board of directors meeting to ascertain that allotment of shares has been made according to the decision of board of directors and articles of association.
(iv) Examination of Counterfoils of Share Book
The auditor should compare the number of shares allotted with the counterfoils of share book and particulars of allottees.

(v) Shares Allotted for Consideration other than cash
The allotment of shares for consideration other than cash means shares allotted to vendors against purchase of assets. When shares are allotted for consideration other than cash, the auditor should examine the contracts made with the vendor and verify from the minutes of board of director’s meeting.

2: Certification of cash received against allotment of shares
All money received from applicants for the allotment of shares is deposited in separate bank account. The auditor should ensure the amount received by comparing the cash book entries with bank statement and the application received for allotment of shares.

3: Certification of receipts & payment account
The auditor can certify the cash receipts and payments of the company with the help of the following points.

(i) Receipt and Payments
The auditor should ensure that the receipts and payments have been prepared up to date within seven days from the date of statutory report.

(ii) Vouching of cash receipts & payment:
The auditor vouches the receipts and payment by referring to supporting document and checks the authorization of transaction.

(iii) Cash & Bank balance
The auditor verifies cash in hand by physical counting and bank balance by obtaining certificates from banks. These certificates are received by sending director confirmation letter.

SPECIMEN OF AUDITORS’ CERTIFICATE FOR STATUTORY REPORT

The Directors,
ABC Ltd,
Lahore.
Dear Sirs,

We being the auditors of the company hereby certify that the report that relates to the shares allotted by the company, to the cash received in respect of such shares and to the receipts and payments of the company is correct. We further certify that the said payments were made for the purpose of the company.

ABC & Co.
Chartered Accountant

Lahore, 31st December 2013
QUESTION # 27

What is annual report? Also explain the audit work involved in the submission of such a report to the shareholders of a public Ltd. Company. (2012)

ANSWER

ANNUAL AUDIT REPORT

The directors of every company are required to place in the annual general meeting, the balance sheet, profit & loss Account and statement of changes in financial position duly audited by the external auditor of the company. The auditor after verification give a report that whether financial statement are giving true and fair view of the state of the affairs of the company such report is called Annual Audit Report.

AUDITOR’S WORK FOR FINAL REPORT

When an auditor is appointed to report on the accounts of a Company and to express his opinion as to the truth and fairness of accounts, the programme of work to be carried out by auditor is stated below.

1. List of the Documents

The auditor should ask the authorities to hand over to him a list of all the documents. The auditor should examine the following documents carefully before commencing the work of audit.

   (a) **Memorandum and Articles of Association**
   
   The auditor should examine the provision of memorandum and articles of association regarding accounts and audit.

   (b) **Certificate of Incorporation of business**
   
   The auditor should examine the certificate of incorporation to ascertain the date when the company was formed, and in the case of a public limited company, the certificate of commencement of business as well.

   (c) **Prospectus**
   
   The auditor must examine the prospectus regarding the capital issue during the period under audit. He should examine the prospectus in case of first audit of a public limited company. In subsequent audits it is not necessary to go through the prospectus.

2. Evaluation of the internal control system

The auditor should examine the system of internal control and administrative controls in the company thoroughly. He should judge its accuracy before launching the specifics audit programme.

3. Previous year’s balance sheet and auditor’s report

The auditor should obtain the balance sheet and other statements of the previous year to ascertain that the balances therein are correctly recorded in the new books. He should also inspect the auditor’s report for the previous years to know whether the recommendations made therein were followed or not by the company.

4. List of Officers

The auditor should ask the authorities for the list of officers with designation and their powers particularly those who pass transactions, sign vouchers and make decisions on accounting matters. He should also take their specimen signatures.
5. List of Books
The auditor should ask the authorities to hand over to him a list of all the books of accounts and registers. Every company keeps at its registered office proper book of accounts and registers as under.

(a) Accounts books relating to sales and purchases, assets and liabilities, money received and expended, etc.
(b) Registers of investment, deposits, charges, shareholders, debenture holders, loans etc.

6. Examination of Books of Accounts
The auditor examines the books of accounts with due care and skill. The books include not only the books of accounts but the term includes all records and all memorandum books such as minute book, cost book, stock register etc.

7. Deduction of Zakat
The auditor should check that Zakat has been deducted and deposited in to Central Zakat Fund according to Zakat and Usher Ordinance 1980.

8. Audit of Profit and Loss Account
The auditor should check profit and loss account of a company with due care to check, to examine that gives a true and fair view of the profit or loss of the company.

9. Audit of Balance Sheet
The auditor is concerned with checking of different assets and liabilities in balance sheet with regards to the truth and fairness of the various information’s disclosed in the balance sheet.

10. Other Statements
The auditor should also examine the statement of changes in equity, cash flow statements and notes which are the parts of financial statements. He should carefully examined that these statements are prepared according to standards or not.