Question and Model Answer

Q.1 What is meant by continuous audit? Discuss, in brief, its advantages and disadvantages. What are the means of removing of those disadvantages ?

❑ Continuous audit

❑ Meaning

A continuous audit is an audit where the auditor and his staff examine, in detail, the books of account of the client at regular or irregular intervals throughout the financial year.

In this system of audit, every transaction is checked minutely. So, it is easy to prepare financial statements of the concern at the year end within a short time.

❑ Advantage

- From the viewpoint of owners

(1) **Knowing financial position in time :** Under continuous audit financial statements can be prepared soon after the close of the financial year. So, owners or shareholders may know the financial results and position of their organisation timely.

(2) **Quick receipt of final dividend :** Timely preparation of financial statements helps the owners to get their final dividend quickly.

(3) **Possibility of receiving interim dividend :** This type of audit helps in preparing interim accounts which enables the directors of a company to declare interim dividend.

(4) **Maintenance of capital intact :** Because of detailed checking of accounts throughout the year possibility of occurrence of errors and frauds in this type of audit is reduced. So, the owners are assured that their capital in the business will remain intact.

- From the viewpoint of auditor

(1) **Possibility of performance of audit efficiently :** As the auditor is in constant touch with the organisation he is in a position to understand its workings and system of accounts keeping. This helps him in conducting his audit in efficient way.

(2) **Even distribution of work :** Continuous audit helps the auditor to rationally allot total workload to his staff. So, audit work can be performed most efficiently.

(3) **Performance of work according to plan :** Under this system auditor can plan his work well ahead in a systematic manner. Thus, it helps him in carrying out audit work according to the plan.

(4) **Detailed checking :** As the audit is carried out throughout the financial year, there is enough time at the disposal of the auditor or his staff to check transactions thoroughly.

(5) **Early detection of error or fraud :** In this case, auditor starts checking of transactions after their occurrence. So, he may detect error or fraud quickly.

(6) **Quick presentation of report :** Under this system auditor can complete most of his routine audit works almost at the end of the financial year. Accordingly, he can submit his audit report shortly.

❑ General

(1) **No pending work :** Due to frequent visits of auditor or his staff, employees of the accounts department of the client usually try to keep their works up-to-date. As a result, there is less chance of any work remaining incomplete.

(2) **Moral pressure on the client's staff :** Frequent visits of auditor and his staff act as a moral check on the client's staff.

(3) **Suggestion from auditor available :** Frequent visits help the auditor to be familiar with the technical details of the client's business. So, he may, in case of necessity, offer better suggestion for improving the working of that business.

❐ Disadvantage

- **From the viewpoint of owners :**

(1) **Expensive :** Frequent visits by auditor and his staff during the whole financial year for carrying out detailed checking of accounts involve much time. As a result, audit expense may be increased. Thus, continuous audit may become an expensive system.

(2) **Unsuitable to small concerns :** Being expensive in nature this type of audit is not generally applicable to small concerns.

(3) **Possibility of interruption in work :** Due to frequent visits of auditor or his staff for checking of accounts some of the books of accounts may be kept with them for audit work. This may disrupt the normal flow of work of the client's office.

(4) **Adverse effect on the employees of the client :** Frequent visits of auditor or his staff and their continuous watch over the accounting staff of the client may create some adverse effect on their mind.

- **From the viewpoint of auditor**

(1) **Chance of falsification of accounts :** Because of frequent visits by auditor and his staff figures in the books of accounts already checked by them at their previous visit may be tampered by a dishonest employee of the client's office to distort the accounts. And it is too difficult for an auditor to detect such a type of fraud.

(2) **Possibility of losing the link in the work :** Audit of accounts of a financial year are conducted, in this system, at different time throughout that year. For this reason, the auditor may lose the link between his past and present work of the year. As a result, certain questions and enquiries placed by him in his previous visit may generally be forgotten in the next visit. So, link in the audit work between these two visits may not be maintained.

(3) **Monotony :** Auditor and his staff visit the client's office again and again in the financial year to check the same set of books of account. Naturally, there may arise monotony in their work.

(4) **Probability of collusion :** Under this system accounting staff of the client usually depend upon the audit staff for any difficulty about accounting procedure. Again, as a result of frequent visits of audit staff an intimacy may develop between the accounting staff of the client and the audit staff. This may lead to a collusion between these two groups of employees for different corrupt practices.

❐ Measure of removing disadvantage

(1) **Preparation of audit programme :** Before starting audit the auditor should prepare a well thought and properly designed audit programme stating therein the extent of work to be completed, allocation of duties and time schedule of various works to be done.

(2) **No alteration in audited figure :** Clear instructions must be given to the client's staff for not making any change in the audited figure without prior permission of the auditor.

(3) **Use of special mark :** Auditor or his staff must use different 'ticks' in their work in such a way so that the client's staff cannot understand the same easily. Besides, before starting audit, alterations, if any, found in the books of account should be marked by special form of ticks.

(4) **Writing of total in ink :** The periodical totals of different books of account as and when checked should be written in ink.

(5) **Use of notebook :** Auditor should use notebook for recording of works completed by him and his staff, totals of all books of accounts, balances of accounts, errors detected and rectified, alternations in audited figures, queries raised by him and his staff and explanations given by the client's staff, queries remaining unanswered and so on.

(6) **Glancing over notes of previous sitting :** Before starting the work the auditor should each time glance over the notebook and books of account to know the totals of all books of account, balances of different accounts, alterations, queries remaining unanswered, extent of work completed upto last visit etc.

(7) **No change in duty of audit staff :** The duties of audit staff allotted as the beginning of the financial year as per audit programme should not generally be changed (except in special case) till the year end. As a result, there will be no interruption in the flow of audit work.

(8) **Completion of a particular job in one sitting :** Audit programme should be prepared in such a way so that the checking of a book or a particular part thereof may be completed in one sitting.

(9) **Checking of nominal account at the year end :** Fictitious entries are ordinarily recorded in the nominal accounts with a view to committing fraud. So, nomial accounts should be vouched at the end of the financial year.

(10) **Surprise visit :** The auditor should pay a surprise visit in such a way so that the client's staff cannot know the date of his visit in advance. Accordingly, they will always remain alert and perform their duties with much care.

Q. 2. Discuss briefly the problems you have to face as an auditor while conducting the audit of accounts kept under computerised environment.

❑ Problem of auditor in carrying out audit of accounts kept under computerised environment

Nowadays in different business and non-business organisations and government departments the use of computer in accounting and, simultaneuously, in carrying out audit works has been gradually increased. But under computer based accounting system an auditor has to face several difficulties. Important difficulties or limitations are :

(1) **Absence of source documents :** Under manual system transactions are recorded in the books of account on the basis of source documents like vouchers, receipts etc. So, the auditor can verify a transaction with the help of the source document. But under computerised environment transactions are directly put into computer for their processing without any source document. So, in this case, some difficulties may arise in verifying the validity of a transaction occurred.

(2) **Want of visible output :** Under mannual system after the completion of recording of transactions their results at different stages can be checked with the help of related books of account and documents. But, in some computer systems the results or output of processing of transactions are not printed or if printed, that is in very short form. Hence, in this case, some inconveniences may arise in checking of accounts.

(3) **Absence of correct output :** If programing can be done properly then correct data or information may be obtained regularly from the computer (if, of course, hardware acts duly) : On the other hand, if programing in computer is not proper, computer cannot give correct output. So, the auditor should have a clear idea about the relevant computer program.

(4) **Problem about alteration in accounts or documents :** Under manual system the auditor can see any pen through, over-writing etc. in the books of account or documents through visual examination. But that is not possible for the auditor under EDP system.

(5) **Possibility of hacking of data or program :** Data or program preserved in computer may easily be collected through internet from computer terminal kept far away. So, if there is no proper internal controls in the organisation concerned, those data or programs may come into the hands of unauthorised persons. Besides, these data or programs may be hacked or stolen.

Q. 3. Write short notes on :

(i) Independent financial audit

(ii) Statutory audit

(iii) Interim audit

(iv) Balance sheet audit

(v) Standard audit

(vi) System audit

(vii) EDP audit

❒ (i) Independent Financial Audit

Independent financial audit or in short, independent audit is the examination of accounts of an entity by a professionally qualified auditor for the purpose of expressing independent opinion on the reliability and fairness of the financial information as reflected in the financial statements.

Auditor, in this case, is appointed by the owner of the entity. He is not an employee of that concern. He is an outsider but a professional chartered accountant. The employer cannot reduce the scope of such audit or restrain the right of this auditor. Independent audit has now been made compulsory for many of the organisations established under different statute or Act.

Independent audit acts as a moral check on the client's staff from committing frauds. It helps in detecting wastages and losses that occur due to absence or inadequacy of internal controls. It protects the financial interest of the persons who are associated with the management. Financial statement audited by an independent auditor is considered a reliable and valuable document by all parties concerned. It is useful for negotiating loans, computing tax liability, calculating purchase consideration and so on.

❒ (ii) Statutory Audit

Audit of an entity which is formed under any statute or Act and made compulsory under that statute or Act is called statutory audit. For example, audit of accounts of a joint stock company in India is obligatory under the Companies Act, 2013. That is why, this type of audit is also known as **compulsory audit.**

Statutory audit is conducted by a duly qualified outsider who is an independent person. He is termed as statutory auditor. He is appointed by the shareholders not by the management. So, he is also known as **external auditor**. His qualification, rights, duties and liabilities are stated in the relevant statute or Act. Nature and scope of such audit are also governed by that statute or Act. Management of the entity concerned has no control over these matters. So, this type of audit falls under the category of **independent audit.**

Statutory audit is applicable in case of (a) joint stock companies incorporated under the Companies Act, (b) banking companies governed by the Banking Companies (Regulation) Act, (c) Cooperative societies registered under the Cooperative Societies Act, (d) statutory institutions formed under special statute or Act (For example, insurance companies, electricity companies, Reserve Bank, Calcutta University etc.) and (e) limited liability partnership firm.

Audit of these entities is in the nature of **complete audit** and is conducted by a qualified chartered accountant. Statutory audit is very useful to all parties related to the entity under audit. Let us take an example. Shareholders of a joint stock company have got no power to examine the books of account and documents of the company. So, they cannot understand whether their interest in the business is duly maintained. Therefore, they have to depend upon the auditor's expert opinion on the issue.

Moreover, his well-thought comments stated in audit report are mostly acceptable to bank, government, income tax authority etc.

❐ (iii) Interim audit

Interim audit is one which is carried out before the end of an accounting year at any time during the midway of that year for some special purposes.

Accounts of an entity like a joint stock company is required to be audited when it intends to declare interim dividend in the middle of an accounting year. So, this type of audit is conducted in between the two annual audits. That is why, this system is known as interim audit. In short, it is carried out for a part of a financial year for a specific purpose. But this audit is not a final audit or part thereof. Because, it is necessary to perform a final audit of a 'complete' accounting year at the year end even after carrying out of interim audit for a particular period of the said accounting year.

With the help of such audit it is possible to **publish** audited **interim accounts**. For this reason, final audit can be completed in lesser time. But this is an expensive system of audit and not suitable to small concerns.

❐ (iv) Balance sheet Audit

The system of audit in which different assets, liabilities, capital, reserve, provision, profit or loss etc. appearing in the balance sheet of an organisation and other accounts closely related to those items are examined is called balance sheet audit.

This type of audit is of recent growth and more popular in U.S.A. than in England or other countries. It consists of the verification and valuation of all items shown in the balance sheet together with the examination of related profit or loss items like repairs and maintenance of assets, depreciation, bad debts etc.

This type of audit is generally applicable to a bigger size of business organisation where (a) volume of transactions is very large, (b) a good and effective system of internal controls or mechanised accounting system is in operation etc. Under this system audit work is completed within a short time. Because, techniques like vouching, routine checking etc. are not generally followed. So, this system is not ordinarily suitable to small concerns.

It should be noted here that under traditional system of audit all transactions are usually vouched in detail with the relevant vouchers and documents. But, in case of balance sheet audit all the transactions, taking place are not generally checked in that manner. But according to section 143(2) of the Companies Act, 2013, the auditor concerned is required to state in his audit report whether balance sheet, profit and loss account and cash flow statement dealt with in the report are in agreement with the books of account and other relevant documents.

Therefore, it is not possible for an auditor to express his opinion on the above matters in his report without detail checking of all books of account, vouchers and other documents in proper way. If he submits the report without such checking, he may be held liable for negligence in his duty.

So, under this condition, before deciding to adopt balance sheet audit approach, the auditor must carefully take into consideration some points like prevalence of effective internal controls etc.

❐ (v) Standard Audit

The system of audit in which all the accounts shown in the books of account of an organisation are not checked with a view to saving of time and labour is called standard audit.

Under this type of audit certain significant items are throughly checked and analysed. Appropriate test checks are applied to the remaining items provided there is an effective system of internal check in operation.

This system is usually found in operation in case of larger size of business organisations. But, as all items are not checked, there is every possibility of some errors remaining undetected, for which the auditor may be held liable for negligence.

Under this system audit programme may suitably be designed. It helps in developing new auditing standards. There is less scope of collusion between the audit staff and the client's staff.

But this system, being expensive in nature, is not suitable to small concerns.

❒ (vi) System Audit

An audit which is conducted to study the adequacy and effectiveness of the accounting system prevailing in an entity is called system audit.

In this system the prevalent accounting practices are assessed to review their effectiveness. If they are found to be ineffective, then appropriate measures are taken for designing proper system of accounting. That is why, some entities often appoint system auditor to review their existing accounting practices to ascertain whether the present system is up-to-date and economical and also sufficient to provide necessary information to the users of accounts. So, the accounting system may be more useful. As a result, possibility of occurrence of errors and frauds is less due to designing of improved accounting system. But the entity concerned has to bear extra cost to introduce this type of audit. Besides, it may face wastage of money if it fails to achieve the desired result.

❒ (vii) EDP Audit

Nowadays in different business and non-business organisations and government departments the use of computer in accounting and, simultaneously, in carrying out audit works has been gradually increased. That means, many entities are now using **electronic data processing** (EDP) in their accounting procedures. Audit under this Computerised Information System (CIS) is known as EDP audit.

So, **EDP audit means the process of audit of accounts of an organisation kept in computerised environment.**

In short, EDP audit is the process of gathering and evaluating audit evidence to ensure that computerised environment protects the assets of the organisation including hardware, software and data by adequate audit procedures.

EDP audit is very helpful to an auditor. Because, under computerised environment any report on a matter of complicated nature may be prepared in a particular format within a very short time. Besides, there is less chance of occurrence of clerical errors. So, by curtailing the work of routine checking the auditor may concentrate on analytical review. Quality of audit work may increase thereby.

But, under this system transactions are directly put into computer for their processing without any source document. So, it is not possible for the auditor to determine audit trial due to absence of source documents. Besides, if there is no proper internal control data or program preserved in computer may be hacked or stolen . Moreover, data or program kept in hard disk or pendrive may be destroyed due to virus or some other reasons like fire etc.

However, EDP audit may be more effective provided the following measures are taken for removing the above limitations :

Adequate and effective internal controls are to be introduced. Separate password should be used for different softwares. Antivirus softwares should be provided so that harddisk, pendrive etc. are not lost due to computer virus. Finally, internet security should be used.

Q. 4 Write short note on 'Teeming and lading'.

❐ Teeming and lading

Teeming and lading is a well-planned means or technique of misappropriation of cash. This method is also known as **'lapping'**. According to **Meigs**, recording of receipt of cash too late with a view to concealing of deficit of cash receipt is called lapping.

So, **the process of misappropriation of cash of an earlier transaction by way of recording in cash book a subsequently occurred cash transaction as a cash transaction occurred earlier is known as teeming and lading method of defalcation.**

This type of misappropriation usually takes place too much in case of sources from which cash is flowing in regularly (For example, receipt of cash from customers) or purposes for which cash is coming out in regular manner. (For example, payment of cash to creditors).

Misappropriation of cash under teeming and lading method is generally possible, if

(i) The same employee collects cash and also writes cash book.

(ii) Bearer cheque instead of A/c payee cheque is paid.

(iii) Proper system of internal cheque regarding cash is not in practice.

This type of fraud cannot easily be discovered. But the possibility of such misappropriation of cash may generally be minimised to some extent if the following steps are taken :

(i) To introduce a proper system of internal check regarding receipts and payments of cash ;

(ii) Receiver of cash, disbursers of cash and recorder of cash transactions should not be the same person but be separate employees ;

(iii) "Only A/c payee cheque will be given to creditors" — a proper notice is to be given in this regard ;

(iv) To balance cash book every working day and compare it with the balance of cash-in-hand ;

(v) To prepare bank reconciliation statement, etc.