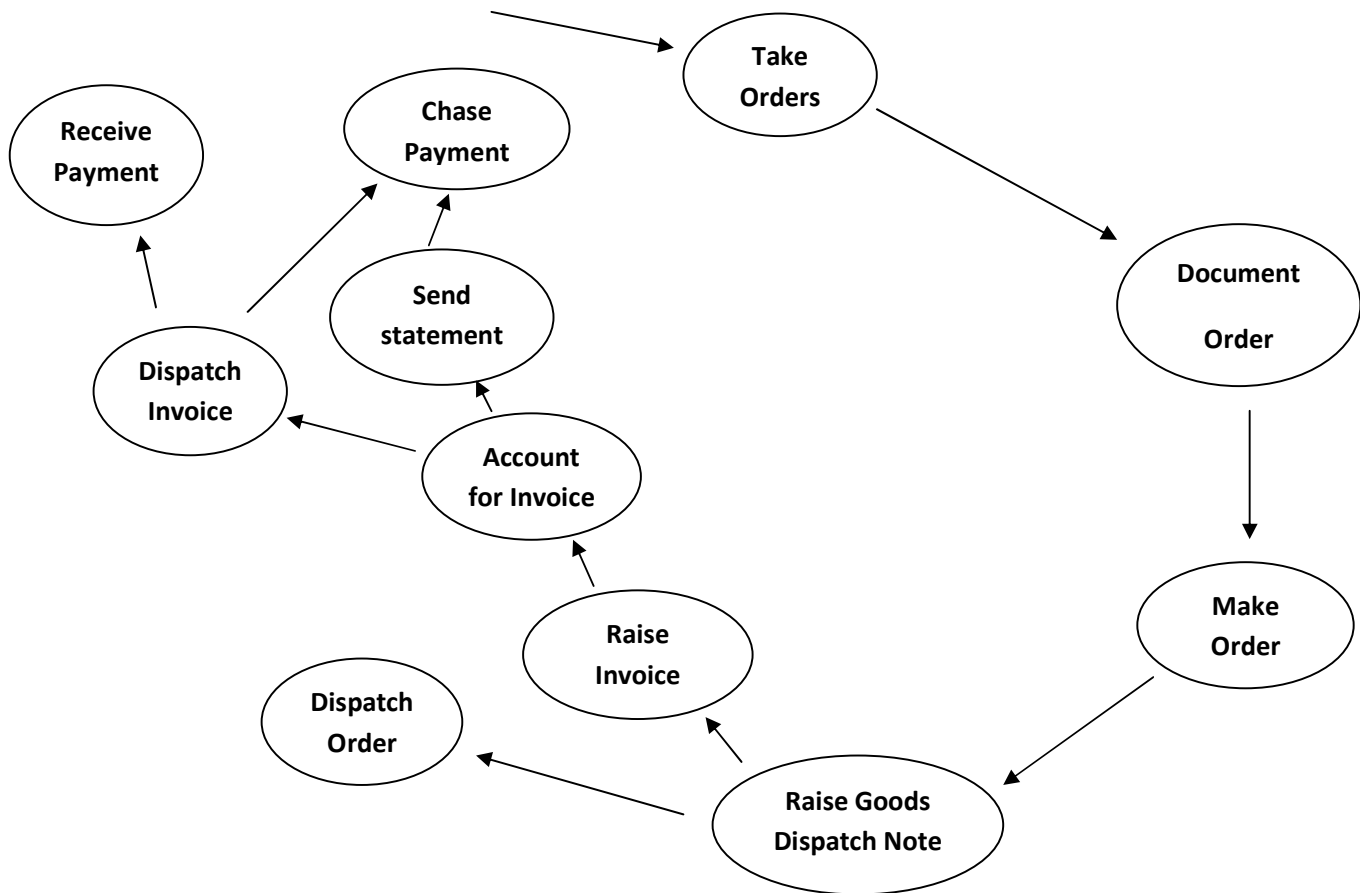


SALES SYSTEM



Test of control in the sales system will be based around:

- Selling. (Authorizations)
- Goods outwards. (Custody)
- Accounting. (Recording)

System = sales.

Sub-system = other than sales.

Here, system means control. Every sub-system has control objectives. Controls always define by control objectives.

No system \Rightarrow **No control** \Rightarrow **DANGER**

Following are the built in controls:

- Authorization.
- Pre-numbering.
- Segregation of duties.

Where segregation of duty is not possible:

Small entity usually has no segregation of duty. The major reason being the cost.

CONTROL OBJECTIVES:

In control objectives, we are talking about controlling:

- Sales income (goods & service).
 - Sale return.
 - Customer claim.
 - Receivable amount.
 - Provision & write off.
1. Customer order should be **authorized, controlled** (should be sold) & **recorded** (double entry should be passed) for prompt execution.
 - Seller = receive order.
 - Customer = purchase order.
 - ✓ Goods & services are only supplied to customer having good credit rating.
 2. Goods shipped (goods) & work completed (services) should be controlled to ensure:
 - Invoice issued/ raised.
 - Revenue recorded.
 3. Goods return & customer claim be controlled to determine:
 - Liability of goods return
 - Claims received
 4. Invoices issued (sale income be recorded) & credit notes (sales return be recorded) are:
 - Checked for accuracy.
 - Authorized before entered.
 - ✓ Credit notes are only to be given for valid reasons.
 5. Sales invoices are:
 - Subsequently paid by customer.
 - Identified doubtful amount like provision & write off.

CONTROL PROCEDURES:

ORDER:

1. No sale/supply should be made beyond credit limit. If credit limit exceeds, sent the case to credit department.
2. Correct prices quoted to customers.
3. Order received is recorded on pre-numbered document (like cash receipt book).
4. Duties must be segregated between:
 - Credit control.
 - Invoicing.
 - Inventory dispatch.
5. Order should is authorized by:
 - Authority.
 - Key personnel.
6. Authorized sale order is used to generate "Dispatch note". No goods to be issued without issue of dispatch note by warehouse.

DISPATCH:

1. Check regularly that dispatch note is invoiced.
2. Dispatch notes are authorized before goods left warehouse. Every document is authorized.
3. Examination of Goods Outwards as to:
 - Quality.
 - Quantity.
 - Condition.
4. Recording of Goods Outwards.
5. Agreement of Goods Outwards to:
 - Customer order.
 - Dispatch note.
 - Invoices.
6. Pre-numbered the dispatch note so as to maintain:
 - Sales invoice.
 - Customer order.

INVOICING & CREDIT NOTES:

1. Sales invoice is:

- Authorized by responsible officer.
- Match with:
 - ✓ Authorize order.
 - ✓ Dispatch note.

Matching gives assurance that quality & quantity as ordered by customer id recorded & rates are same.

Invoice will be sent by:

- Faxed.
- Courier.
- Email.
- Postal.
- Real time.

2. Invoice & credit notes be entered in:

- Day book.
- Sale ledger.
- Sale ledger control account.

Entry in sale ledger control account will be:

Sale ledger control account	XXX	
Sale income		XXX

3. Invoice & credit notes be checked for:

- Prices. (Sales price -- trade discount + sales tax)
- Casts. (Total be checked by independent persons like auditor)
- Calculations. (quantity * rate)

4. Cancelled invoice copies are retained. It should not be discarded or sent to bin.

5. Dispatch notes be cancelled (against cancelled invoice) & signed by responsible officer.

6. Credit note (sales return document) be authorized by independent person not being:

- Dispatcher.
- Sales ledger personnel.

7. Distinguish invoice between:

- Different sales
- VAT rates.
- Sales tax rates.

✓ Coding should be periodically checked.

RETURN:

1. Check for damage. If goods are damaged due to our fault, accept the responsibility & raise the document.
2. Issue credit note against goods return.

DEBTORS:

1. Regular preparation & checking of debtor by independent person.
2. Debtor ledger personnel should be independent from cash receipt.
3. Regular sending statement of due amount.
4. Send letter for over due collection. Entity should have a policy of legal course of action.
5. Procedure should exist for follow up of overdue debt highlighted by:
 - Regular customer statement.
 - Aging list.

BAD DEBT:

1. Authority for bad debt write off should be in written form. Every one should not be given this authority.
2. Use of:
 - Court action.
 - Write off bad debt.

Should be authorized by person independent of cash receipt function.

TEST OF CONTROLS:

Purpose of test:

- ✓ Control procedure is applied.
- ✓ Objectives are achieved.

1. Carry out Sequence test check (pre-no of doc) on:
 - Invoices.
 - Credit notes.
 - Dispatch order.
 - Order sales.

It ensures:

- No omission.
 - No duplication.
 - All items are included.
2. Existence of authorization proof taken for:
- Acceptance of order. (Credit worthiness check)
 - Dispatch of goods.
 - Pricing & discount.
 - Write off of bad debt.
 - Raising of:
 - ✓ Invoices.
 - ✓ Credit notes.

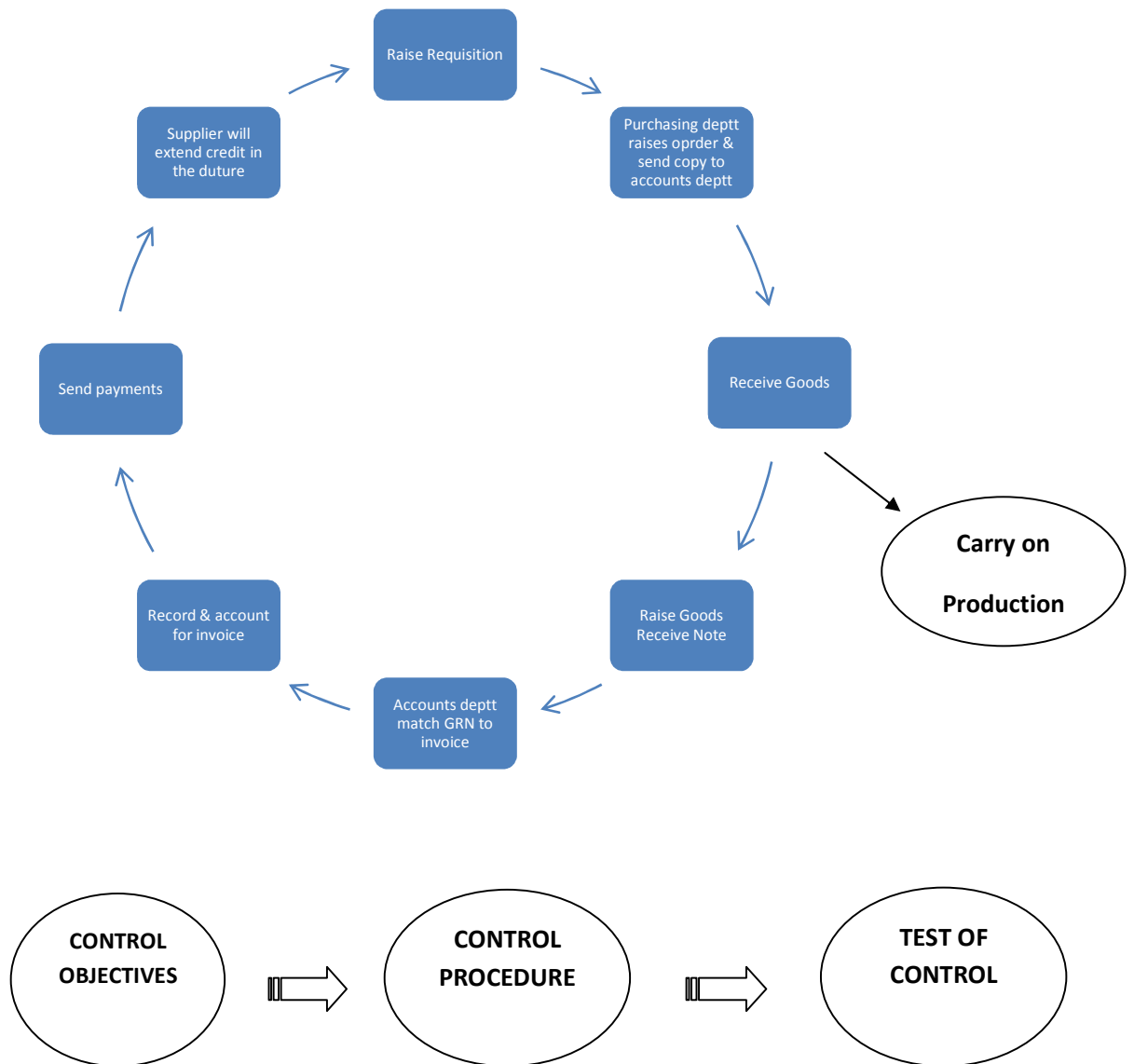
If authorization exist, it's ok otherwise there is an element of danger.

3. Check arithmetical accuracy of:
- Invoices. (Pricing/total/sales tax/VAT should be checked by independent person)
 - Credit notes.

Grid stamp: signature of authorized personnel & entity own code on the face of document. Ensure that control has been applied by checking the accuracy of such invoices & credit notes.

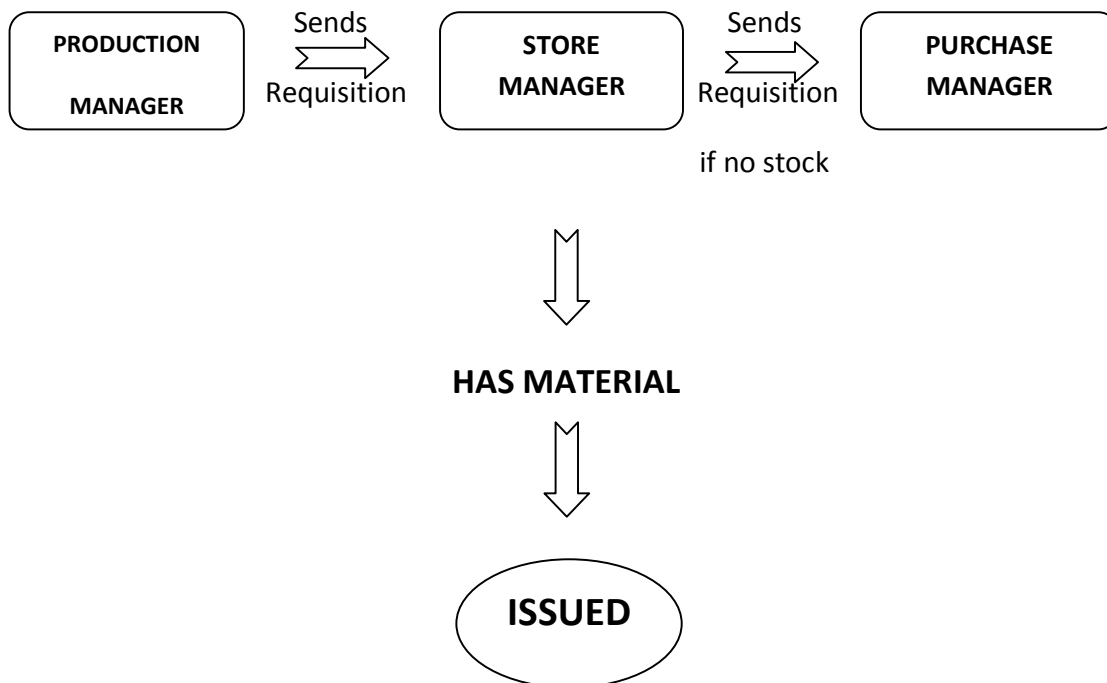
7. Check Dispatch Note (base for invoice note) & Goods Receive Note (credit note base) ensure:
- Invoices.
 - Credit notes.
8. Ensure that control account reconciliation is:
- Performed.
 - Reviewed.
9. Verify credit notes with:
- Correspondence of other supporting documents.
 - Approved by authorized official.
 - Calculations & additions.
 - Postings to sales ledger.
 - Entries in inventory record.
 - Entries in good returned records

PURCHASE SYSTEM



Test of control in the sales system will be based around:

- Buying. (Authorizations)
- Goods Inwards. (Custody)
- Accounting. (Recording)



Purchase deptt will never buy goods on their own will. He has to purchase when he gets requisition by:

- Store.
- Operation.
- General Manager.

CONTROL OBJECTIVES:

1. Order goods & services under appropriate:
 - Authority.
 - Procedure.
 - ✓ Authorized supplier.
 - ✓ Competitive prices.
2. Invoices & related documents should be:
 - Properly checked.
 - Approved as being valid.

Before recognize them as creditors.

3. Inspect received goods & services for:
 - Quality.
 - Quantity.
 - Description.
4. Necessary goods & services are ordered for:
 - Proper conduct of business operations.
 - By suitable supplier.

There are two types of purchases:

- Regular Purchase. (Identify 2 to 3 supplier & give order to them only).
 - Occasional purchase. (Call quotation from outside entity & give order).
5. Valid transactions related to payables are recorded accurately in accounting records:
 - Credit notes.
 - Adjustments.
 - Supplier invoice.

CONTROL PROCEDURES:

ORDERS:

1. Requisition notes should be authorized. Segregation of duties at:
 - Requisition.
 - Ordering.
 - Accounting.
 - Checking functions.
2. Order authorized by responsible officer.
3. Major items like capital expenditure should be authorized by Board of Directors.
4. Order should be recorded in official documents showing:
 - Suppliers name.
 - Quantity ordered.
 - Price.
 - Time received.
 - Responsible officer.
 - Discount:
 - ✓ Trade discount.
 - ✓ Settlement discount. (Prompt payment discount. Also called cash discount.)

5. Copies of order should be retained as a method of following up late deliveries by supplier. This tells us which supplies are received & which are pending.
6. Pre-set the:
 - Re-order levels.
 - Maximum levels.
 - Minimum levels.
 - Danger levels.
 - Quantities.
 - Lead times.

It should preferably be recorded in advance in requisition note.

RECEIPT OF GOODS:

1. Identify Goods Inward Area to deal with the receipt of all goods. Which gate to enter the goods we purchased & who will receive the goods/ receiving office.
 - Gate keeper.
 - Store In charge.
 - Inspection deptt.
2. Check goods for:
 - Quantity.
 - Quality.
 - Description.

Goods Received Notes (Internal doc made by inspection deptt)/Goods Inward Notes/ Goods Inspection Notes should be:

- Raised for all accepted goods.
 - Signed by responsible officer.
3. Check Goods Received Notes against:
 - Purchase orders.
 - Procedure should exist to notify the supplier of:
 - ✓ Under delivery.
 - ✓ Over delivery.

Goods Received Notes should be:

- ✓ Sequentially numbered.
- ✓ Checked periodically for completeness.

INVOICES & CREDIT INVOICES:

Payables figure depends on these notes.

- ✓ Invoices received means we are recognizing liability against creditors.

✓ Credit notes shows amount of note will not be paid to supplier anymore. The reasons are credit notes are received against purchase returns.

✓ Check Invoices:

- Accuracy
- Calculations.
- Proper recording.
- Classifications.
 - For Non-current asset, debit asset.
 - For raw material, debit material store.
 - For office supplies, debit operating expenses.

1. Purchase Invoices (Piece of paper which is sales invoice from supplier point of view) should be:

- Stamped with approval grid.
- Give unique serial no (17/current date/supplier code) to ensure that invoices do not go astray so that it should not be issued to other supplier.

2. Check invoice against:

- Goods Received Notes.
- Order.
- Also check:
 - ✓ Casts.
 - ✓ Calculations.

3. Match purchase invoice against:

- Goods Received Notes.
- Company order.
- Not processed until this (above) is done.

4. Invoice should be signed for approval & payment by responsible officer (not receiving officer).

5. Check invoice sequential no with purchase day book in detail.

6. Record input tax (sales tax paid at purchase time) VAT separately by invoice total.

Cost	xxx
VAT	xxx
Total	<u>xxx</u>

Entry will be:

Purchase 100

Sales tax 15 (100*15%)

Creditor 115

7. Invoice should be properly posted to nominal ledger account. Coding should be checked independently.
8. Maintain batch control over posting invoice to :
 - Nominal ledger.
 - Purchase ledger.
 - Purchase day book.
9. Goods return record:
 - Be kept.
 - Check to credit note receives by supplier.

PURCHASE LEDGER & SUPPLIER:

1. Maintain:
 - Payable ledger control account.
 - Regular check control account balance against purchase ledger by independent person.
2. Payable ledger record be kept by person independent of:
 - Receiving goods.
 - Invoice authorization.
 - Payment routines.
3. Statement by supplier should be checked against ledger account. Every supplier sent statement of account to customer. It is a reminder that we issued these invoices to you against which such amount is payable by you (receivables for us).

TEST OF CONTROLS:

A most important test of controls is for auditors to check that all **invoices** are **supported** by authorized by **purchase invoices & purchase orders**. The officials who approve the invoices should be operating within laid-down **authority limits**.

Get sufficient appropriate audit evidence that control procedure is applied & control objectives are achieved.

**PURCHASE
ORDER**

TEST FOR:

- Evidence of Sequence Checks e.g 1-2-3-4.
- Evidence (signature) of approval. (by responsible person)
- Adherence to authority limits. E.g.
 - ✓ Capital expense – Board of Directors.
 - ✓ Stationery/raw material – Manager.

NOTE: Purchase order is made for purchase for goods.

**GOOD
RECEIVED
NOTES**

TEST FOR:

- Evidence of sequence check.

NOTE: Good received Note is made when ordered goods are received by us.

**PURCHASE
ORDER**

TEST FOR:

- Evidence of serial no.
- Evidence of sequence check (grid stamp).
- Evidence of matching purchase invoice with Good Receive Note & Purchase order.
- Evidence of check:
 - ✓ Casts (+, -, *, /).
 - ✓ Tax treatment.
 - ✓ Extensions.
- Evidence of account coding (same code for individual & payables).
- Initialing of invoice grid for work done.

NOTE: Recognition of Account payable & Purchases depends on it.

- ✓ Control procedure is adopted by audit client.
- ✓ Test of control is adopted by auditor.

**CREDIT
NOTE**

TEST FOR:

- Evidence of matching Credit Notes to Good Return Note. (A doc which contain reasons & no for goods returned)

NOTE: It cancels the affect of an invoice. It is used when purchased goods are returned. We get credit note by supplier in return. Purchase invoice & credit note is issued by supplier. Credit note is received when supplier is satisfied that goods are actually faulted.

**PAYABLE
LEDGER**

TEST FOR:

- Evidence for authorization & adjustments to payable ledger.

NOTE: It is a purchase ledger which contains the individual ledger of creditors.

- ✓ Main ledger – whose final balance is written in trial balance.
- ✓ Subsidiary Ledger – contains memorandum record.

**PAYABLE
LEDGER
CONTROL ACC**

TEST FOR:

- Evidence of review of reconciliation of purchase ledger listings.
- Evidence of authorization of adjustments to purchase ledger account.

NOTE: Balance sheet based on these accounts.

CASH

- No cash control means great loss.
- Cash disappear anytime.
- Control over cash receipt should prevent theft & fraud.
- Very sensitive area.
- No leakage of cash.
- Cash includes:
 - ✓ Currency notes.
 - ✓ Hard cash.
 - ✓ Coins.
 - ✓ Banking transactions through cheques, standing orders, traveler cheque etc.

CONTROL OBJECTIVES:

1. All sums due to company are:
 - Received.
 - Account for.
2. No payment is made which should not be made. Alternatively, no extra cash or twice payments.
3. All receipts & payments are:
 - Properly recorded.
 - Accurately recorded.
 - ✓ All transactions should be in banking way especially payments. Cash payment is not allowed in internal control. It is a weakness.
 - ✓ Hard cash may be received but it should be discouraged.

CONTROL PROCEDURES:

CONTROL OVER CASH RECEIPT BY POST

Key controls over **receipts** include:

- Proper post opening arrangement.
- Prompt recording.
- Prompt banking.
- Reconciliation of records of cash received & banked.
- Regular independent bank reconciliations.

Big & systematic organizations receive cash/cheque through debtor by:

- Postal mail.
- Courier service. Etc.

1. Safeguard against possible interceptions between receipt & opening of post by:

- Using locked mail box.
- Restricting access to keys.

NOTE: Only responsible person will open the envelope.

2. Opening of post be supervised by responsible officer. If volume of mail is significant, at least two persons be present be there when the mail is opened.

PROBLEM: If any person opens the envelope & no officer is present there & cheque is not crossed, then it will be stolen.

✓ No cross cheque at all times is received.

3. All cheques & postal orders should be restrictively crossed “**ACCOUNT PAYEE ONLY NOT NEGOTIABLE**” as soon as the mail is opened.

✓ It might already appear on the cheque when it will be received. If not, it should be added.

✓ Uncrossed cheque = Hard cash.

4. Immediately made record of:

- Cheque & postal order received.
- Cash receive.

NOTE: Record means **REMITTANCE LIST/ROUGH CASH BOOK** that contains:

✓ Date.

✓ Amount.

✓ Name of receiver.

5. No access to receipt of:

- Cashier.
- Sales ledger personnel. (Person who record transactions in debtor subsidiary ledger)

Before the record (remittance list) is made.

✓ Cheque should not be received by:

- Cashier.
- Sales ledger personnel.

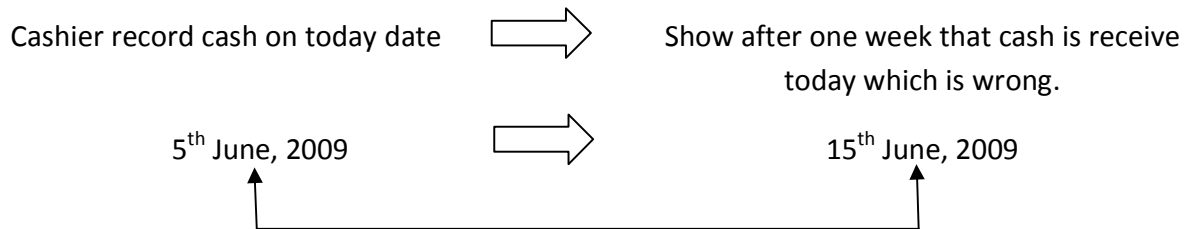
6. Receipt should be kept in:

- Locked safe. (Not left open)
- Other security area.

& banked immediately.

7. Post should be date stamped. Provide evidence of when:

- Remittance is received.
- Can periodically be checked against date of banking.
 - ✓ Adopt this procedure where:
 - No cross cheque.
 - Hard cash received.



Use cash for (during 10 days):

- Personal purpose.
- Buying fixed deposit certificate etc.



This is called “**TEEMING & LADING / CASHIER KI FUNKARI**”. This helps in preventing cash received on one day being banked later after few days & using cash for personal purposes.

- ✓ Loss to the company is that bank will charge high interest.

CONTROL OVER CASH COLLECTED BY SALESMAN & REPRESENTATIVES

1. Authority to collect cash should be clearly defined.
2. Salesman & other representative should be required to remit cash & report sales at regular intervals.
3. Responsible officer should follow up the salesman who has not yet submitted cash on return as required.
4. Collection should be recorded when received in:
 - Rough cash book.
 - Copies of receipt which should be given to salesman or travelers.
5. Collector / representative cash receipt should be reconciled to eventual banking (through pay in slip (document use for deposit of cash)/ bank euro) which should be made as promptly as possible.
6. Responsible officer should check salesman own receipt book (cash memo) with cash book entries periodically (weekly, after 10 days, as determined).

7. If salesman held inventory of goods (present in outlet/sent sales by going somewhere as walls & o'more ice cream sales man do), independent reconciliation be made of inventory with:

- Sales
- Cash received.

No of units to be sold = 100

Sale unit = 90 (90 * 10% = 900 cash received)

Unsold unit = 10

CONTROL OVER CASH SALES

Cash sale & salesman sale is **TWO** different things.

- ✓ A cash sale/counter sale is like department store sale where mostly cash sale is done.
- ✓ A salesman sale/street vendor sale is tricycle sale by walls & o'more ice cream vendors.

1. Cash sales be recorded at the point of sale is made. Usually this is by means of:

- Cash till.
- Receipts.
- E-cash register.
- Use of cash sale invoice.

2. If cash sale invoice/receipt (memo) is issued, they should be pre-no. Maintain register for cash sale book & copies (counter foil) should be retained.

NOTE: Cash sale invoice is not simple sale invoice. Simple sale invoice is against credit sales.

3. Cash received be reconciled daily with either:

- Till roll.
- Invoice total.

Cash should be banked promptly.

4. Daily banking be checked against:

- Till roll.
- Invoice total.

& difference should be investigated.

5. Responsible officer should sign the cancelled cash sale invoice at transaction time. All such invoices should be checked periodically for sequential numbering.

CONTROL OVER BANKING OF RECEIPT

1. Receipt should be:
 - Banked daily.
 - Banked intact. (No use of single rupee)
 - ✓ No cash pay out of cash receipt.
 - ✓ It allows control.
2. Each day receipt should be recorded promptly in cash book/book of original entry/book of subsidiary entry/Journal & ledger.
3. Sale ledger personnel should have no access to:
 - Cash.
 - Preparation of pay-in-slip.
4. Periodically a comparison/reconciliation should be made between split of cash & cheque:
 - Received. (& recorded in cash book)
 - Banked. (& recorded in pay-in-slip)

CONTROL OVER CHEQUE PAYMENTS

1. Unused cheque/leaflets should be held in safe/secure place. Any one can steal it. It should be with responsible person.
2. Person who prepares cheque should have no responsibility over:
 - Purchase ledger. (Record of creditors) – He can do favor & sent him early payment.
 - Sales ledger. (Record of debtors) – He can refund.
3. Cheque should be signed when evidence of properly approved transaction is available. Form of evidence includes:
 - Invoices.
 - Payroll.
 - Petty cash book.
 - Agreement.
4. This control (Above one) should be evidence by signing the supporting document. E.g payroll & invoice.
5. In large entity, those person approving documents should be independent of those signing the cheques.
6. Cheque signatories should be restricted to minimum practical no to make operation of control as practical as possible.
7. Two signatories should be required except perhaps for cheque of small amount.

- ✓ Small amount = one man sign.
- ✓ Large amount = two/three man sign.

REASON: If one overlook, other can detect it.

8. Prohibit:

- Signing blank cheque.
- Cheque in favor of signatory.

NOTE: If signatory sign his name cheque, it is a big control weakness.

9. Cheque should be crossed “ACCOUNT PAYEE ONLY”. If this is not, pre-printed on cheque before being signed.

- ✓ Only cross cheque should be issued.

10. Supporting documents be cancelled as “PAID” to prevent further use of support further cheque payments. To avoid duplicate payment, “PAID” stamp be affixed.

11. Dispatch cheque immediately. If not, keep it in safe place. (Delay means chance of loss increase).

12. Returned cheque may be obtained by bank & sample checked against:

- Cash book entries.
- Supporting docs.

CONTROL OVER BANK RECONCILIATIONS

1. Reconciliation should be prepared on regular basis. At least monthly, quarterly & annually.

- ✓ Separate statement for separate bank.

2. Responsible officer be independent of receipt & payment function.

3. If reconciliation is made by independent person, he should obtain bank statement directly by bank & hold them until reconciliation is completed.

CONTROL OVER PETTY CASH

Use in organization where there is:

- ✓ No cash transaction.
- ✓ Cash deposit in bank intact.

1. Lay down formally:

- Level of (max level)
- Location of (where to put)

Cash float (Use for petty cash balance).

2. There should be restricted access to cash float.

3. Cash should be secretly held with:

- Safe custody.

- Locked drawer.

With restricted access to keys.

4. All expenses should require a voucher signed by responsible officer (not the petty cashier).
 5. Use imprest system to reimburse the float. I.e. at any time the total cash * value of authorized voucher not reimburse (top up) equals the set of amount.
 6. Voucher should be produced before the cheque to top up the cash float is signed.
 7. Voucher should be cancelled once reimbursement has taken place.
 8. Minimum amount be placed in petty cash payment to discourage normal purchase procedure being by-passed.
 9. Petty cash book be maintained by petty cashier. Entries should be made promptly.
 10. Petty cash float should be periodically reconciled to the balance in petty cash book by independent person. (Teeming & lading can occur if violated).
 11. Rules should exist preferably for:
 - Preventing issues of IOU's.
 - Cashing of personal cheque for employee.
- ✓ **IOU's** = I OWE YOU. (I am your debtor). Use when any official person uses money for few days by petty cashier.

TEST OF CONTROL:

CASH RECEIPT

1. Attend mail opening & ensure procedures are adhered to.
2. Test independent check of cash receipt to bank lodgment. Two independent persons for:
 - Cash receipt.
 - Cash payments.
3. Test for evidence of sequence check on any pre-no receipt of cash.
4. Test authorization of cash receipt.
5. Test for evidence of arithmetical check on cash received records.

CASH PAYMENT

1. Inspect current cheque books for:
 - Sequential use of cheque.
 - Controlled custody of unused cheque.
 - Any signatures or blank cheque.
2. Test (To avoid double payment) to ensure that paid invoices are marked "PAID".

3. Test for evidence of arithmetical check on cash payment record including cash book.
4. Examine evidence of authority for current:
 - Direct debits.
 - Standing orders.

BANK RECONCILIATION

1. Examine evidence of regular bank reconciliation. (Usually monthly)
2. Examine evidence of independent check of bank reconciliation. E.g. signatures.
3. Examine evidence of follow up of outstanding items on bank reconciliation. Give attention to old outstanding reconciling item that should be written back like un-presented cheque.

PETTY CASH

1. Test petty cash vouchers for approval.
2. Test cancellation of paid petty vouchers.
3. Test evidence of arithmetical accuracy on petty cash record.
4. Examine evidence of independent check of petty cash balance.

INVENTORY

- ✓ Inventory fraud means fraudulent financial reporting.
- ✓ Closely connected with sales & purchase system.
- ✓ Some companies, particularly smaller ones, rely on the inventory count taking place at or near the balance sheet date & in this case, the auditor will use a substantive approach to an audit.
- ✓ Other companies, particularly large ones, have very good day to day controls over inventory than others & have complex system of perpetual inventory in place which means that an annual year end count is not necessary. However, in order to rely on such system, the auditor must confirm that the controls over the system are strong & operating effectively.

CONTROL OBJECTIVE:

- ✓ **Although inventory records vary client to client, the controls are same.**
1. Authorization & purchase procedure.
Levels of inventory;
 - ✓ Store level. It includes:
 - ❖ Factory/production related inventory.
 - ❖ Office supply inventory. (E.g. stationery)
 - ❖ Shipping supplies inventory.
 - ✓ Work shop level.
 - ✓ Ware house/Godown level. (FG inventory)
 2. Control over goods inward. (GRN)
 3. Inventory record supported by physical inventory counts.
 4. Adequate steps should be taken to identify all inventories for which provision may be needed on ground that their NRV (Based n prudence concept) is below cost.
 5. Inventory level should be controlled so that material is available when required but that inventory is not unnecessary large.
Inventory level means:
 - Re-order level.
 - Maximum level.
 - Minimum level.
 - Danger level.Unnecessary large inventory:
 - ✓ Increase storage cost.
 - ✓ Investment blockage.

6. Control over:

- Dispatches.
- Goods outwards to:
 - ✓ Warehouse.
 - ✓ Workshop.
 - ✓ Customer.

When inventory location is changed, it should be documented.

CONTROL PROCEDURE:

APPROVAL & CONTROL OF DOCUMENT

1. Issue by stock be made only on properly authorize documents.
2. Review the:
 - Damage inventory.
 - Slow moving/not used inventory.
 - Obsolete/out of fashion/ out of date inventory.

Any write off be authorized.

ARITHMETCAL ACCURACY

1. All receipt & issue be:
 - Recorded in inventory card.
 - Cross reference to GRN.
2. Costing deptt be allocate value of WIP as per % completion method.
3. Use standard cost. Review it to ensure that it relate to actual cost being incurred.
4. Value of WIP is directly comparable to no of unit made. Check be periodically made of actual unit against WIP record.

CONTROL ACCOUNT

Main ledger

One main account

Subsidiary ledger

many accounts

- Maintain total inventory record & integrate it with main account system. If so, reconcile with detail inventory record & discrepancies investigated.

COMPARISON OF ASSET TO RECORDS

1. Inventory level should be periodically checked against record by person independent of store personnel & material difference be investigated.
 - ✓ No perpetual inventory record = full inventory count once a year
2. Minimum, maximum & re-order stock level should be:
 - Pre-determined.
 - Regularly reviewed for adequacy.

ASSESS TO ASSET & RECORDS

1. Separate center should be identified where goods are held.
2. Held stock at location safe by:
 - Damage.
 - Theft.
3. Good delivered by supplier be pass by good Inward section to store & hence be:
 - Recorded.
 - Checked as receive.
4. All stock line should be:
 - Identified.
 - Held together.

In a bin which is marked with all relevant info as to:

- ✓ Size.
- ✓ Origin.
- ✓ Grade.
- ✓ Title.

TEST OF CONTROL:

1. Observe:
 - Physical security of inventory.
 - Environment where it is held.
2. Test procedure for record of inventory movement in & out of stock.
3. Test authorization for adjustment to stock record.
4. Test authorization for:
 - Write off.
 - Scrapping of stock.
5. Test control over recording of inventory movement belonging to third party.

6. Test procedure for authorization for inventory movement. E.g use of goods receives & dispatch note.
7. Inspect reconciliation of stock count to stock record.
8. Check sequence of:
 - Goods receive note.
 - Dispatch note.For completeness.
9. Assess adequacy of inventory count procedure & attend count to ensure they are carried out.

PAYROLL

- ✓ Payroll means wages & salaries.
- ✓ One of the most important systems.
- ✓ Key payroll controls:
 - Documentation & authorization of staff changes.
 - Calculation of wages & salaries.
 - Payment of wages.
 - Authorization of deductions.
- ✓ Why payroll is to be outsourced:
 - Maintaining independence.
 - No one getting the salary information of other one internally.
 - Less fraud chance.
 - E.g. ufone & mobilink outsource their payroll.
- ✓ It is given to employee as:
 - Wages.
 - ✓ Time rate.
 - ✓ Price rate.
 - Salary. (Monthly & annually)
 - ✓ Permanently

CONTROL OBJECTIVE:

1. Payment should be made to client's authorized employees.
 - ✓ Authorized employee's means who work for the entity.
2. Payment should be made at authorized rate of pay.
3. Payment should be made in accordance with work performed. E.g.
 - Time.
 - Output.
 - Commission on sales.

Attendance related information is to be collected by:

- ✓ Clock card.
- ✓ Swap card.
- ✓ Biometric device like thumb impression, retina etc. For biometric devices, False Acceptance & Rejection rate must be low.
- ✓ Register.

4. Payroll & payroll deductions be made accurately. E.g.
Deductions may be:
 - ✓ Statutory.
 - Tax.
 - Social security.
 - Insurance.
 - Provident fund.
 - ✓ Non-statutory.
5. Payment should be made to correct employee. Avoid ghost employees (employee not exist but getting salary).
6. Properly record liabilities to tax authorities for:
 - Tax
 - Social security.Liabilities means:
 - ✓ Deductions.
 - ✓ Payroll payables.

CONTROL PROCEDURE:

APPROVAL & CONTROL OF DOCUMENTS

1. Written authorization to:
 - Employ an employee.
 - Dismiss an employee.
2. Change in rate of pay should be authorized in writing by official outside wages deptt. HR/Personnel deptt will have right to decide the wage rate.
3. Overtime work should be authorized in advance by:
 - Manager.
 - Supervisor.
4. Independent official should:
 - Review payroll
 - Sign it.
5. Wage cheque should be signed by two signatories & agreed with signed payroll.
6. Where weekly pay relates to hour at work, clock card should be used. There should be supervision on:
 - Clock card.
 - Smart card.
 - Timing device.

Particularly when employees are clocking on & off.

- ✓ **CLOCK CARD:** check on in & out time of employee.
- ✓ **SMART CARD:** swap the card.

7. Where piece rate system operates, payment should be made for work of an appropriate quality which has been:

- Inspected.
- Approved.

E.g In Pakistan, shoe factory use piece rate for soul pasting worker. Supervisor will supervise it.

8. Personnel record should be kept independently of payroll deptt for each employee giving details of:

- Engagement.
- Retirement.
- Dismissal.
- Resignation.
- Rate of pay.
- Holiday.

Specimen signature of an employee.

9. Wage supervisor be appointed who perform some authorization duties listed above.

ARITHMETICAL ACCURACY

1. Where appropriate, payroll should be prepared by:

- Clock card.
- Job card.

& sample checked for accuracy against rate of pay.

2. Payroll detail should be checked for accurate calculation of deductions.

- Tax.
- Social security.
- Pension.
- Trade union subscription.

CONTROL ACCOUNTS

1. Account should be maintained in respect of each deduction showing amount paid periodically to:

- Inland Revenue.
- Trade union.
- Social security.

2. Overall analytical check should be carried out to highlight major discrepancies. E.g.
 - Check against budget.
 - Check against personnel record.
 - Change in amount paid over period of time.
3. Management should exercise overall:
 - Review.
 - Control.

ACCESS TO ASSET & RECORD (DISBURSEMENTS)

MAIN POINTS:

- ✓ Cash disbursement in small entity is OK.
- ✓ Big entity should not give hard cash as salary. Reasons being:
 - Risk of theft / robbery due to large withdrawal by bank.
 - Payroll sheet is difficult for bank to handle & crediting salaries to employee account.
- ✓ **BACS (BANK AUTOMATIC CLEARING SYSTEM)**

It is a United Kingdom scheme for the electronic processing of financial transactions. BACS Direct Debits and BACS Direct Credits are made using the BACS system. BACS payments take **three** working days to clear:

- They are entered into the system on the first day,
- Processed on the second day, and
- Cleared on the third day

Summarily developing CD that is compatible with that bank system where entity account & their employee account exist. Entity sent CD containing payroll details of all the employees of an organization to the bank at the month end. CD run on the bank system within second & all salary will be transferred thus saving bank time.

1. Employee should sign for their wages.
2. No employee should be allowed to take wage of another employee.
3. When wage are claimed late, employee should:
 - Sign for wage packet (salary slip).
 - Release of packet should be authorized.
4. System should preferably allow wage to be check by employee before packet is opened by using specially designed wage packet.

5. Duty of wage staff be rotated during the year & ensure that no employee is responsible for all the function in respect of any particular deptt.
6. Employee making pay packet (cheque, payroll sheet, pay-in-slip) should not be the employee who prepares payroll.
7. Surprise attendance at pay out should be made periodically by independent official.
8. Unclaimed wages should be recorded in register & held by someone outside wage deptt until claimed or until pre-defined period after which the, money should be re-banked. An official should investigate the reason for unclaimed wages as soon as possible.

TEST OF CONTROL:

1. Test sample of:
 - Time sheet.
 - Clock card.
 - Other card.

For approval by responsible official. Pay particular attention to approval overtime where relevant.
2. Test authority for payment of casual labor particularly if in cash.
3. Observe wage distribution for adherence to procedure ensuring:
 - Employee sign for wages.
 - That unclaimed wages are re banked etc.
4. Test authorization for payroll amendments by reference to personnel record.
5. Examine evidence of checking payroll calculation. E.g. sign of financial controller.
6. Examine evidence of approval of payroll by responsible officer.
7. Examine evidence of independent check of payroll.
8. Inspect payroll authorization.
9. Test authorization for payroll deductions.
10. Test control over unclaimed wages.
11. Examine explanation for payroll expense variance.

BANK BALANCE VERIFICATION

Bank balance means:

- Deposit balance.
- Overdraft balance/running finance.
- Regular loan account balance.

Account types:

- Fixed /Time deposit.
- Demand deposit/Current account/ P&L sharing account.
 - ✓ We can withdraw cash anytime we want.

VERIFICATION POINTS:

1. Agree balance with:
 - Cash Book/Bank book.
 - General ledger.
 - Bank statement.
2. In case of difference between bank book & bank statement, obtain reconciliation for bank account.
 - We make reconciliation when bank & cash book disagree. **MAKE RECONCILIATION WHEN CASH & BANK STATEMENT DISAGREE.** The reason being:
 - ✓ Balance can agree if there is mistake. Mistake in debit & credit side can nullify the mistake.
 - ✓ If balance agrees, check:
 - Unpresented /outstanding cheque.
 - Uncollected cheque.
3. Check that Unpresented /outstanding cheque have been cleared with bank statement subsequent to year end.
 - ✓ It verifies that no bogus cheque is issued.
4. Check that uncollected cheque has been realised with bank statement subsequent to year end.
 - ✓ It verifies that no bogus cheque is collected.

5. Scrutinize the subsequent bank statement for dishonored cheque on order to detect worthless cheque deposited to conceal shortage.
6. Investigate any significant reconciling item of an unusual nature.
 - ✓ There are only three reconciling item in bank statement inclosing date:
 - Unpresented /outstanding cheque.
 - Uncollected cheque.
 - Bank mistake.
7. Investigate about outstanding stale (outdated) cheque. It should be reversed in cash book.
8. Obtain direct bank confirmation.

Letter to bank by auditor asking to confirm:

- Bank balance.
- Allied matters.

It includes:

1. Full account title.
2. Exact balance.
3. Account closed during the period.
4. Interest charged during the period. Check that the whole interest is debited to P&L account.
5. Detail of security & charges.
6. Detail of investment & documents held with:
 - Bank.
 - Self.

DEBTOR VERIFICATION

- ✓ Major procedure usually achieved by direct contact with customers.
 - ✓ ISA 505 *External Confirmation* covers confirmation of receivable.
 - ✓ Confirmation is essentially an act of client.
 - ✓ Confirmation satisfy these assertions w.r.t debtors:
 - Existence.
 - Right.
 - Obligation.
 - Accuracy.
1. Obtain confirmation by debtor. Normally positive confirmation is taken for:
 - Debtors.
 - Creditor.
 - Bank balance.
 2. Verify debt with reference to cash received since year end (B/S date).
Last B/S show debtor = Rs: 100000/-.
In next year, check that cash is received from debtor. If not received,
DANGER.
 3. Check:
 - Accuracy.
 - Completeness.

For debtor listing.
 4. Check book keeping in small sample of ledger accounts. For sample of balances, agree individual entries back to:
 - Sale invoice. (invoices should be in client name)
 - Bank statement.
 - Credit notes.
 5. Check posting & enquire into unusual entries in control account.
Unusual entries means:
 - Set off (debtor is also creditor).
 - Transfer of balance.
 - Contra.
 - Payment to debtor.

(Excess cash received from debtor is refunded. Normally we receive cash by debtor).

6. Review post year end credit notes. Credit notes are given normally against sale return.
7. Enquire into debtor balance cleared by journal entry after year end.
8. Consider:
 - Unprovided claim. (No provision against debtor)
 - Enquiries.
 - Review correspondence.
9. For provision for rebates:
 - Consider adequacy.
 - Check bases.
 - Check calculations.
10. Consider whether results of cut off affect debtors.
11. Calculate debtor day figure (analytical procedure) & compare it prior year. If ratio is rising, discuss with directors how this affects:
 - Bad debts.
 - Provision for doubtful debts.
12. At the final stage of audit:
 - Obtain most recent breakdown of debtors.
 - Establish which year end balance remains uncollected.
13. For uncollected items:
 - Review customer correspondence file for evidence of:
 - ✓ Problems.
 - ✓ Disputes.
 - Discuss findings with top management & directors.

DEBTOR CONFIRMATION LETTER

By debtor confirmation letter, auditor obtains information regarding:

1. Adequacy of internal control over:
 - Sale.
 - Debtor.
 - Collection.
2. Accuracy of:
 - Accounting record in general.
 - Cut off procedure for B/S purpose in particular.

3. Irregularities like:

- Teeming & lading. (Cash received but not recorded)
- Overdue balance.
- Incorrect balance.
- Nil balances.
- Old, unpaid accounts.
- Accounts settled by round sum payments.
- Accounts with credit balances.

The auditor form opinion from above information that:

1. Reliability of debtor balance.
2. Quantum & nature of dispute existing between:
 - Company.
 - Customer.

Method of obtaining confirmation includes:

1. Positive.
2. Negative.

Timings: Ideally the confirmation should take place immediately after the year end & hence cover the year end balances to be included in the balance sheet.

Due to time constraint, carry out the confirmation **prior to year end** provided that confirmation is **no more than three months** before the year end & internal controls are **strong**.

Bad Debts: Recoverability of bad debts can be tested by a combination of methods.

STOCK IN TRADE, STORE & SPARE VERIFICATION

- Stock in trade: finished goods (which we have to sell).
 - Store & spare:
 - ✓ Raw material.
 - ✓ Indirect material.
 - ✓ Spare parts.
 - ✓ Shipping supply.
 - ✓ Office supply.
1. Verify:
 - O/B of last year B/S.
 - Auditor work paper.
 2. Examine:
 - Stock taking instruction issued by client.
 - Assess adequacy for proper stock count.
 3. Observe counting of inventory at selected location.
 4. Check final summary of stock prepared from stock count sheet.
 5. Store record keeping:
 - Review.
 - Check.
 6. Check that:
 - Slow moving inventory.
 - Damaged inventory.
 - Obsolete inventory.
 - Are segregated.
 7. Check cutoff.
 - GRN cut off.
 - Sale invoice cut off.
 - Dispatch note cut off.
 8. Check inventory calculation for rate to be applied in inventory valuation.
 - Important area:
 - ✓ Rate. Rate should cover all cost elements.
 - ✓ Stock count.
 - Three cost element:
 - ✓ Direct material.

- ✓ Direct labor.
- ✓ Factory overhead.
- IAS-02 cost element:
 - ✓ Direct material.
 - ✓ Conversion cost.
 - Direct labor.
 - Factory overhead.

9. Check stock valuation. (COST OR NRV RULE)

- Stock valuation means value of stock shown in B/S. It not means FIFO/LIFO/AVCO.
- FIFO/LIFO/AVCO is the method of inventory cost.

10. Check source document for:

- Purchase.
- Consumption.
- Purchase return.
- ✓ Source document cost is used for per unit cost determination.

11. Reconcile of closing balance.

Opening balance	XXX
Add – Purchase	XXX
Less -- Purchase return	XXX
Less – cost of sales (consumption)	XXX

12. Inventory presentation as per:

- IAS/IFRS.
- Companies Ordinance, 1984.

EXPENSE VERIFICATION

DIRECTOR FEE:

- ✓ Not a payroll.
- ✓ Not a salary.
- ✓ Not disclose with normal salary.

1. Examine Articles of Association to ascertain the mode of determining the rates of fee.
2. Examine minutes of meeting to ensure that only fee rate agreed are paid to director.
3. Where fee is payable as per meeting attendance, examine attendance to ensure that only attendance is paid.
4. Ensure that proper receipt is obtained by payee.
5. Check proper disclosure in financial statements as per:
 - IAS/IFRS.
 - Companies Ordinance, 1984.

INTEREST ON LONG TERM LOAN:

- ✓ It includes:
 - Interest on borrowing.
 - Interest on debenture.
 - Interest on bank loan.
 - Interest on loan certificate. Etc.

1. Interest calculated on amount due for period due.

Loan : Rs: 100000/-
Taken on : July 01, 2009
Year ended on: Dec 31, 2009

Interest calculation will be as follows:

$$100000 * 10\% = 10000 * 6/12 = 5000.$$

2. Obtain loan agreement & read its term & conditions.

- See:
 - ✓ Rate of return.
 - ✓ Terms.

- ✓ Conditions.
 - ✓ Date of repay.
3. Check interest rate mentioned in the agreement.
 - See:
 - ✓ Read agreement.
 - ✓ Interest arte.
 - ✓ Agreement.
 4. Check accruals of interest in case of non-payment.
 5. Check payment voucher with bank advice.
 6. Ensure:
 - Amount of interest.
 - Rate of interest.
 - Capitalized as per IAS-23.

Is properly disclosed.

DEPRICIATION OF FIXED ASSET:

- ✓ Expense.
 - ✓ Shown in:
 - Operating expense in P&L account.
 - Production cost in P&L account.
1. Check:
 - O/B of asset cost.
 - Accumulated depreciation.

With last year audited financial statements.
 2. Ensure depreciation policy is:
 - Appropriate.
 - Applied consistently.

Method of depreciation as per economic benefit pattern.

Same benefit	:	straight line method.
Reduce benefit	:	written down value.
Proportionate benefit	:	sum of year digit method.
Unit produce	:	unit of output method.

Periodic review of:

- ✓ Depreciation method.
- ✓ Useful life.

3. Verify that depreciation:

- Add.
- Disposal

During the year is in accordance with accounting policy.

4. Analytical review:

- Reasonableness of depreciation.
- Disclosure.
- Consistent with prior year.

STAFF LOAN:

- ✓ Account balance.
- ✓ Appear as asset in B/S.

1. Examine:

- Entity service rules & regulation.
- Provision for staff loan in staff rule.

2. Internal control:

- Examine.
- Evaluate.

3. See application form for loan:

- Length of service.
- Pay scale/grade.
- Responsibility.
- Object of obtaining loan.

4. Ensure that loan is properly authorized. (See BOD resolution)

5. Examine:

- Agreement with staff.
- Ensure terms are adhered to.

6. Obtain certificate direct by staff. Loan certificate confirm bogus loan.

7. If loan is secured:

- Examine the security.
- Reasonableness of security.

8. See that adequate provision for amount of recovery is made in the accounts.