

MOCK TEST PAPER – 2
IPCC/PCC: GROUP – II /GROUP – 1
PAPER – 6/2: AUDITING AND ASSURANCE
SUGGESTED ANSWERS/HINTS

- 1 (a) According to AS – 10, Accounting for Fixed Assets, when fixed asset is acquired in exchange or in part exchange for another asset, the cost of asset acquired should be recorded either at fair market value or at the net book value of the asset given up. In the present case the latter is more evident (₹ 10 lakhs given up) than the fair value of motor car (₹ 10.50 lakhs estimated by the directors). Hence, the Customer's account should be credited with ₹ 10 lakhs and the motor car recorded at the same account.

AS – 1, Disclosure of Accounting Policies, the accounting treatment and presentation in the financial statements of transactions and events should be governed by their substance and not merely by legal form. The motor car has not been registered in the name of the company on the date of the balance sheet in the present case. Taking accounting principle of substance over form into consideration as laid down by AS – 1 the auditor should ensure that the car's acquisition is recorded in the present year though the car is not registered in the name of the auditee.

- (b) **Selection of Audit Sample:** Audit Sampling means the application of audit procedures to less than 100% of the items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The audit sample collection on a random basis ensures that all items in the population have an equal chance of selection, for example, by use of random number tables. This method is considered appropriate, provided the population to be sampled consists of reasonably similar units and fall within a reasonable range.

Thus, strictly speaking, in case of selection of an audit sample on the basis of random tables there is no need to follow any other statistical process for selection of sample.

In fact, selection of an audit sample on random basis is the pre-requisite for application of statistical techniques. However, certain methods such as Haphazard Sampling and Block Sampling may result in selection of a sample which is not free from bias.

Therefore, whenever audit sample selection has been done on a random basis i.e. selection of a representative sample, no statistical process for selection of sample needs to be followed.

- (c) As per AS-6 on Depreciation Accounting, assessment of depreciation and the amount to be charged in respect thereof in an accounting year/period are usually based on the following three factors:-

- (i) Historical Cost.
- (ii) Expected useful life of the asset.
- (iii) Estimated residual value of the asset.

If the management's estimate of the useful life of an asset is shorter than that envisaged under the relevant statute (Companies Act) the depreciation is appropriately computed by applying a higher rate. The depreciation rate provided in Schedule XIV is the minimum rate and a company can charge higher than those prescribed. Hence, in the instance case decision of Pepsi Ltd., to write off the cost of water treatment plant over four years is absolutely correct and as per AS-6.

However, the company has wrongly charged full year's depreciation during 2010-11 instead of half year's depreciation as per requirement of Schedule XIV. The auditor should highlight this to the company and ask to rectify the same.

- (d) **Internal Audit System and CARO, 2003:** As per Para 4(vii) of CARO, 2003, statutory auditor is required to comment on whether the auditee company has an internal audit system commensurate with its size and nature of its business.

The clause has a mandatory application in respect of listed companies. For other companies, it is applicable if either of the following conditions is satisfied:

- a. The company has a paid-up capital and reserves exceeding ₹ 50 lakhs at the commencement of the financial year, or
- b. The company has an average annual turnover of ₹ 5 crores or more for a period of 3 years preceding the current financial year.

In the instant case, the second condition has been fulfilled by JKT Ltd. Hence, the auditor will have to mention in his report the fact of not having such internal audit in his report by the Company.

2. (a) **Audit Risks:** As per "SA 200 (Revised) Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.
- (b) **Audit Trail:** 'Audit trail' refers to a situation where it is possible to relate, on a "one – to –one" basis, the original input with the final output. In a manual accounting system, it is possible to relate the recording of a transaction of each successive

stage enabling an auditor to locate and identify all documents from beginning to end for the purposes of examining documents, totalling and cross – referencing. In first and early second generation computer systems, a complete audit trail was generally available. However, with the advent of modern machines, the EDP environment has become more complex. This led to use of exception reporting by the management which effectively eliminated the audit trail between input and output. The lack of visible evidence may occur at different stages in the accounting process, for example:

- i. Input documents may be non-existent where sales orders are entered online. In addition, accounting transactions such as discounts and interest calculations may be generated by computer programmes with no visible authorization of individual transactions.
- ii. The system may not produce a visible audit trail of transactions processed through the computer. Delivery notes and suppliers invoices may be matched by a computer programme. In addition, programmed control procedures such as checking customer credit limits, may provide visible evidence only on an exception basis. In such cases, there may be no visible evidence that all transactions have been processed.
- iii. Output reports may not be produced by system or a printed report may only contain summary totals while supporting details are retained in computer files.

Special audit Techniques: In the absence of audit trail, the auditor needs the assurance that the programmes are functioning correctly in respect of specific items by using special audit techniques. The absence of input documents or the lack of visible audit trail may require the use of Computer Assisted Audit Techniques (CAATs) i.e. using the computer as an audit tool. The auditor can use the computer to test:

the logic and controls existing within the system, and
the records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor. The effectiveness and efficiency of auditing procedure may be enhanced through the use of CAATs. Properly, two common types of CAATs are in vogue, viz., test pack or test data and audit software or computer audit programmes.

- (c) **Reliance on the Work of Internal Auditor:** The external auditor should as a part of his audit, carryout general evaluation of the internal audit function to determine the extent to which he can place reliance upon the work of the internal auditor. As per SA 610 "Using the Work of Internal Auditors ", factors that may affect the external

auditor's determination of whether the work of the internal auditors is likely to be adequate for the purposes of the audit include:

Objectivity

- The status of the internal audit function within the entity and the effect such status has on the ability of the internal auditors to be objective.
- Whether the internal audit function reports to those charged with governance or an officer with appropriate authority, and whether the internal auditors have direct access to those charged with governance.
- Whether the internal auditors are free of any conflicting responsibilities.
- Whether those charged with governance oversee employment decisions related to the internal audit function.
- Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance.
- Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

Technical competence

- Whether the internal auditors are members of relevant professional bodies.
- Whether the internal auditors have adequate technical training and proficiency as internal auditors.
- Compliance with the mandatory/ recommendatory Standards on Internal Audit (SIAs) issued by Internal Audit Standards Board of the Institute of Chartered Accountants of India (ICAI).
- Whether there are established policies for hiring and training internal auditors.

Due professional care

- Whether activities of the internal audit function are properly planned, supervised, reviewed and documented.
- The existence and adequacy of audit manuals or other similar documents, work programs and internal audit documentation.

Communication: Communication between the external auditor and the internal auditors may be most effective when the internal auditors are free to communicate openly with the external auditors, and:

- Meetings are held at appropriate intervals throughout the period;
- The external auditor is advised of and has access to relevant internal audit reports and is informed of any significant matters that come to the attention of the internal auditors when such matters may affect the work of the external

auditor; and

- The external auditor informs the internal auditors of any significant matters that may affect the internal audit function

The degree of reliance that a statutory auditor can place on the work done by the internal auditor is also a matter of individual judgement in a given set of circumstances. The ultimate responsibility for reporting on the financial statements is that of the statutory auditor. It must be clearly understood that the statutory auditor's responsibility is absolute and any reliance he places upon the internal audit system is part of his audit approach or technique and does not reduce his sole responsibility.

3. (a) Effect of Subsequent Events: SA 560 "Subsequent Events", establishes standards on the auditor's responsibility regarding subsequent events.

According to it, 'subsequent events' refer to those events which occur between the date of financial statements and the date of the audit report, and facts that become known to the auditor after the date of the auditor's report. It lays down the standard that the auditor should consider the effect of subsequent events on the financial statements and on the auditor's report.

The auditor should obtain sufficient appropriate evidence that all events upto the date of the auditor's report requiring adjustment or disclosure have been identified and to identify such events, the auditor should:

- (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- (b) Inquiring of management and, where appropriate, those change with governance as to whether any subsequent events have occurred which might affect the financial statements.

Examples of inquiries of management on specific matters are:

- Ø Whether new commitments, borrowings or guarantees have been entered into.
- Ø Whether sales or acquisitions of assets have occurred or are planned.
- Ø Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- Ø Whether there have been any developments regarding contingencies.
- Ø Whether there have been any developments regarding risk areas and contingencies.
- Ø Whether any unusual accounting adjustments have been made or are contemplated.

- Ø Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
 - Ø Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
 - Ø Whether any events have occurred that are relevant to the recoverability of assets.
- (c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (d) Reading the entity's latest subsequent interim financial statements, if any.
- (e) Read the entity's latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.
- (f) Inquire, or extend previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims; or
- (g) Consider whether written representations covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.

When the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements. If such events have not been considered by the management and which in the opinion of the auditor are material, the auditor shall modify his report accordingly.

- (b) **Audit Working Papers:** As per SA 230(Revised) "Audit Documentation" Audit Working Papers are the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

Working papers are the

- (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor; and
- (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Besides they serve a number of additional purposes, including the following:

- Ø Assisting the engagement team to plan and perform the audit.

- Ø Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
- Ø Enabling the engagement team to be accountable for its work.
- Ø Retaining a record of matters of continuing significance to future audits.
- Ø Enabling the conduct of quality control reviews and inspections.
- Ø Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Retention of working papers: Working papers should be retained, long enough, for a period of time sufficient to meet the needs of his practice and satisfy any legal or professional requirement of record retention. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

4. (a) **Change in Accounting Policies:** Same accounting policies are adopted for similar events or transactions in each period so as to enable the user to compare the financial statements of an enterprise over a period of time. However, Accounting Standard 5, "Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies" provides that accounting policies can be changed under the following circumstances:
- (1) if the adoption of a different accounting policy is required by statute; or
 - (2) for compliance with an accounting standard; or
 - (3) if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise. AS 5 also requires any change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, contained in that Accounting Standard. However, disclosures required by AS 5 should be made unless the transitional provisions of any other Accounting Standard require alternative disclosures in this regard. For instance, how an enterprise should deal with intangible items appearing in its balance sheet when it applies AS 26, Intangible Assets, for the first time.

- (b) **Sweat Equity Shares:** The Companies (Amendment) Act, 1999 recognised that in the wake of globalisation of corporate sector, the employees will have to be rewarded suitably to share in the growth of a company.

By insertion of new section 79A, the employees may be compensated in the form of 'Sweat Equity Shares'. "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. The auditor may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled:

- (i) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting;
- (ii) the resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- (iii) not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence business;
- (iv) the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

However, in the case of a company where equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the prescribed guidelines.

(c) General Considerations in Framing a System of Internal Check: The term "internal check" is defined as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". The following aspects should be considered in framing a system of internal check:

- (1) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.
- (2) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.
- (3) Every member of the staff should be encouraged to go on leave at least once in a year so that frauds successfully concealed by such a person can be detected in his absence.
- (4) Persons having physical custody of assets must not be permitted to have access to the books of accounts.

- (5) There should be an accounting control in respect of each important class of assets, in addition, these should be periodically inspected so as to establish their physical condition.
- (6) The system of Budgetary Control should be introduced.
- (7) For stock-taking, at the close of the year, trading activities should, if possible, be suspended. The task of stock-taking, and evaluation should be done by staff belonging to other than stock section.
- (8) The financial and administrative powers should be sub divided very judiciously and the effect of such division should be reviewed periodically.
- (9) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.

5. (a) **Board's Powers to Appoint an Auditor:** The appointment of an auditor is complete only on the acceptance of the offer by the auditor. The non-acceptance of appointment by the auditor does not result in any casual vacancy. Moreover, even if the auditor is existing one, the matter would not make any difference since the appointment has to be made at each AGM and the auditor must accept the same. The casual vacancy is said to arise only in case of death, resignation, etc. Therefore, the Board is empowered to fill such a vacancy. Section 224(3) of the Companies Act, 1956, empowers the Central Government to fill up a vacancy in case no auditors are appointed or re-appointed at an annual general meeting (AGM). (It is also opined that the appointment of an auditor having been made by shareholders, sub-section (3) cannot be invoked Thus the auditor could only be appointed by shareholders at general meeting). Thus, the Board of Directors are not authorised to fill up the vacancy in case the existing auditor (s) appointed at the Annual General Meeting refuse to accept the appointment.

(b) **Appointment of Auditors:** The implication of shareholding of 51% of paid-up capital by various co-operative and term lending institutions is two fold as discussed below:

In terms of Section 224A of the Companies Act, 1956, a company in which not less than 25% of the subscribed share capital is held, whether singly or in any combination, by:

- (i) a public financial institution or a Government company or the Central Government or any state government; or
- (ii) any financial or other institution established by any Provincial or State Act in which a State Government holds not less than 51% of subscribed share capital; or
- (iii) a nationalised bank or an insurance company carrying on general insurance business,

the appointment or re-appointment of an auditor in the Annual General Meeting shall be made only by passing a special resolution.

In this case, NM & Co. were appointed as auditors of the public limited company where 51% of the paid-up share capital was held by co-operatives and term lending institutions. Presuming that such institutions are covered by the aforesaid criteria, passing a special resolution was necessary. Hence, the appointment of NM & Co., chartered accountants, was null and void provided such institutions are covered by Section 224A.

Section 619 B read with Section 619 of the Companies Act, 1956 requires that a company in which the central government or any state government or any government company or any government corporation hold either singly or jointly not less than 51% of the paid-up share capital, the auditors of such companies are to be appointed by the central government on the advice of the Comptroller and Auditor General of India.

However, the co-operative and term lending institutions are not covered within the definition of corporation/institution owned by the Central/State Government. Accordingly, the provisions of Section 619 will not apply in this case, although the co-operatives and term lending institutions hold majority share capital.

- (c) **Comment on Matters Contained under Section 227(1A) of the Companies Act, 1956:** Section 227(1A) of the Act deals with duties of an auditors requiring auditor to make an enquiry in respect of specified matters. The matters in respect of which the enquiry has to be made by the auditor include relating to loans and advances, transactions represented merely by book entries, investments sold at less than cost price, loans and advances shown as deposits, etc. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1A) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. Therefore, the auditor of Trilok Ltd. is correct in non-reporting on the matters specified in Section 227(1A).

- (d) **Appointment of auditor as a liquidator:** Regulation 191 of the Chartered Accountants Regulations, 1988 allows a chartered accountant in practice, subject to the control of the Council, to act as a liquidator. But a chartered accountant at the same time cannot act both as liquidator and auditor of the company.

The Institute of Chartered Accountants of India, in order to establish a healthy convention, recommended that in cases where a chartered accountant acts as a liquidator, the statement of accounts to be filed u/s 551(1) of the Companies Act, 1956 should be audited by a qualified chartered accountant other than the chartered accountant who is the liquidator of the company.

The appointment of Mr L, chartered accountant, to carry out both the functions as a liquidator and as an auditor will not be proper having regard to the concept of auditor's independence. Thus Mr L, chartered accountant, cannot act both as the liquidator and the auditor.

6. (a) (i) Trade creditors:

- (a) Check the adequacy of cut off procedure to ensure that transaction of next period are not accounted and all transactions of year end are accounted.
- (b) Check posting in the bought ledger from books of prime entry.
- (c) Compare the balances in the schedule of creditors with balances in bought ledger.
- (d) Compare the balances with the confirmation or statement of account received from trade creditors.
- (e) Pay special attention to long outstanding items and enquire about the reason thereof.
- (f) Verify subsequent payments and reversal entries in the bought ledger of year end entries.
- (g) See that trade creditors are classified and shown in the balance sheet as per requirement of Schedule VI to the Companies Act 1956.

(ii) Wages Paid to Seasonal Labourers

- (a) Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers.
- (b) Examine that these labourers are hired on proper authority and the rates of pay are authorized at appropriate levels.
- (c) Ensure that the attendance is properly checked by the Time Keeping Department.
- (d) Check that the certificate regarding work done by the labourers has been given by the proper person, in case the labourers have been appointed on a per piece basis.
- (e) Check the computation of wages payable to the labourers, after taking into account the deductions.
- (f) Confirm that all the payment to the labourers have been acknowledged.
- (g) See the time and job records, to ensure that the labourers have been paid for time worked. See the treatment of abnormal idle time.
- (h) Reconcile the number of seasonal labourers on payroll as per the Personnel Department's records vis-à-vis the number of labourers to whom the wages have been paid, to ensure that there are no ghost workers. This assumes

greater importance, if the seasonal labourers are hired on temporary basis, and not on permanent payroll.

- (b) (i) Examine the constitution, powers of governing body and relevant rules relating to preparation and finalisation of accounts. In case, it is constituted as a company limited by guarantee, application of provisions of the Companies Act, 1956 should also be seen.
- (ii) Vouch the receipt on account of entrance fees with members applications, counterfoils issued to them, and minutes of the Managing Committee.
- (iii) Vouch Members' subscription with the counterfoils of receipts issued to them. Trace receipts for a selected period to the Register of members; reconcile the amount of total subscription due with the amount collected and the outstanding. Check totals of various columns of the Register of Members and tally them across. See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery. The amount considered irrecoverable, if any should be written off.
- (iv) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscription received in advance have been correctly adjusted.
- (v) Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests as well as with the fees chargeable for the special service rendered such as billiards, tennis, etc. Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.
- (vi) Vouch purchase of sports items, furniture, crockery, etc., and trace their entries into the respective stock registers. Vouch purchases of food-stuffs, cigars, wines, etc. and test their sale price so as to confirm that the normal rates of profit have been earned on their sales.
- The stock of unsold provisions and stores, at the end of the year should be verified physically and its valuation checked.
- (vii) Check the stock of furniture, sports material and other assets physically with the respective stock registers or inventories prepared at the end of the year.
- (viii) Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts, also ascertain that the arrangements for their safe custody are satisfactory, check the accrual of income therefrom and provision of income tax thereon.

7. (a) **Concept of Materiality:** This concept is fundamental to the process of accounting. It covers all the stages from the recording to classification and presentation. It is therefore, an important and relevant consideration for an auditor who has constantly to judge whether a particular item or transaction is material or not.

SA 320 on Materiality in Planning and Performing an Audit deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. SA 450 explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. Financial statement materially effected if such statement is erroneously stated or omitted to be stated therein and economic decision of the users taken on the basis of such information is influenced by such misstatement or omission.

Auditor has to ensure that such items are properly and distinctly disclosed in the financial statements.

(b) **'Advantage of statistical sampling in auditing'**

- (i) The sample size does not increase in proportion to the increase in the size of population.
- (ii) The selection of more objective and is based on mathematical law of probability.
- (iii) This method gives a minimum sample size associated with a specified risk and precision level.
- (iv) It also provides a means for taking a calculated risk and corresponding precision i.e., the probable difference in the result due to checking of transaction on sample basis in lieu of checking the entire universe.
- (v) It may provide a better description of large mass of data than a complete examination of all the data.

(c) **Contents of Audit Note book:** Audit note book contains large variety of matters observed during the course of audit. Significant matters observed during audit which should be recorded in audit note book are normally the following:

- (i) Audit queries not cleared immediately.
- (ii) Mistakes or irregularities observed during the course of audit.
- (iii) Unsatisfactory book-keeping arrangements, costing method.
- (iv) Important information about the company which is not apparent from the accounts.
- (v) Special points requiring consideration at the time of verification of annual accounts.

(vi) Important matters for future reference.

(d) Examination in Depth: It implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction, i.e., from initiation to the completion of the transaction by receipt or payment of cash and delivery or receipt of the goods. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure. For example, a purchase of goods may commence when a predetermined re-order level has been reached. The ensuing stages may be summarised thus:

- (i) Requisitions are pre-printed, pre-numbered and authorised;
- (ii) official company order, also sequentially pre-numbered, authorised and placed with approved suppliers only;
- (iii) receipt of supplier's invoice;
- (iv) receipt of supplier's statement;
- (v) entries in purchases day book;
- (vi) postings to purchase ledger and purchase ledger control account;
- (vii) cheque in settlement;
- (viii) entry on bank statement and returned "paid" cheque (if requested);
- (ix) cash book entry;
- (x) posting from cash book to ledger and control account, taking into account any discounts.
- (xi) receipt of goods, together with delivery/advice note;
- (xii) admission of goods to stores;
- (xiii) indication, by initials or rubber stamp on internal goods inwards note, of compliance with order regarding specification, quantity and quality;
- (xiv) entries in stores records.

It should be noted that the above list is not necessarily comprehensive, nor does its constituent stages inevitably take place in the sequence suggested. The important point to note is that from the moment it was realised that once a re-order level had reached, a chain of events was put in motion, together leaving what may be termed as "audit trail". Each item selected for testing must be traced meticulously, and although sample sizes need not be large, they must, of course, be representative.

It is an acceptable practice to check a slightly smaller number of transactions at each successive stage within a depth test, on the statistical grounds (based on

probability theory) that the optimum sample size decreases as the auditor's "level of confidence" concerning the functioning of the system increases. Examination in depth has been found indispensable in modern auditing practice and, if intelligently conducted, its reconstruction of the audit trail reveals more about the functioning (or malfunctioning) of the client's system in practice than the haphazard and mechanical approach to testing.