

PAPER – 3 : ADVANCED AUDITING

Answer Question Nos.1 and 2 and any four from the rest.

Question 1

As an auditor, how would you deal with the following?

- (a) In the audit of an organization whose objects are charitable or religious, the organization holds that the Accounting Standards are not applicable to it since only a very small proportion of its activities are business in nature. (5 Marks)
- (b) During the audit for the year ended on 31st March, 2009 of XYZ Ltd. you come across certain personal expenses of employees having been debited to Profit and Loss account. (4 Marks)
- (c) While conducting the audit of ABC Ltd. for the year ended on 31st March, 2009, you find that the company has disposed off substantial part of the fixed assets, but the management of the company represents to you that they will continue in business. (4 Marks)
- (d) A Ltd. has not made provisions for proposed dividends in its accounts but proposes to charge the dividends to Profit and Loss account as and when paid. (5 Marks)

Answer

- (a) Applicability of Accounting Standards

Explanation

The Accounting Standards (AS) are issued for the use in the presentation of general purpose financial statements which are issued to the public by such 'commercial, industrial or business enterprises' as may be specified by the Institute from time to time. They become mandatory on the dates specified in the respective AS or notified by the council in this behalf.

The reference to 'commercial, industrial or business enterprises' is in the context of the nature of activities carried on by an enterprise rather than with reference to its objects. AS apply in respect of commercial, industrial or business activities of any enterprise irrespective of whether it is profit oriented or is established for charitable or religious purposes. AS will not, however, apply to those activities which are not of commercial, industrial or business in nature (e.g. an activity of collecting donations and giving them to flood affected people).

The exclusion of an entity from the applicability of the AS is permissible only if no part of the activity of entity is commercial, industrial or business in nature. In other words, even if a very small proportion of the activities of an entity is considered to be commercial, industrial or business in nature, then it can not claim exemption from the application of

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AS. In such a case, the AS will apply to all its activities including those which are not commercial, industrial or business nature.

Conclusion

In view of the above discussion, the contention of the organisation that only a very small proportion of its activities consist of business in nature, is wrong and AS would apply to all its activities including charitable or religious.

(b) Personal expenses of employees (debited to profit and loss account)

Explanation

The practice of meeting certain types of personal expenses of employees by the company is considered normal and is being recognised by the statutory authorities also. The charging of such personal expenses of the employees by the company to its profit and loss account is justifiable or not depends upon the terms and conditions of appointment of the employees. If the terms and conditions of employment include payment of expenses of personal nature, then such expenses can be incurred by the company. Where, however the contract of employment does not contain any provision for payment of expenses of a personal nature, then there is no warrant for incurring or reimbursement of such expenses by the company. Illustration of such expenses are medical re-imbursement, conveyance for personal use, expenses on leave travel, maternity benefits, provisions of rent free quarters, canteen facilities etc.

Conclusion

Thus, charging of such personal expenses to profit and loss account either on the basis of company's contractual obligations or in accordance with the accepted business practice is perfectly normal and legitimate and does not call for any comments by the auditor. However, where personal expenses not covered by contractual obligations or by accepted business practice, is charged to profit and loss account, it would be the duty of the auditor to report thereon in terms of Section 227 (IA) of the Companies Act, 1956.

(c) Going Concern

Explanation

Paragraph 4 (1) (c) of CARO 2003, requires the auditor to comment, in case where a substantial part of the fixed assets has been disposed off during the year, whether such disposal has affected the going concern status of the company. For this purpose, the auditor should carry out audit procedure and gather sufficient and appropriate audit evidences to satisfy himself/herself that the company shall be able to continue as a going concern for the foreseeable future, despite the sale of substantial part of fixed assets. The auditor should use his professional judgement to determine whether an asset or group of assets sold by the company is a substantial part of fixed assets.

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Audit procedure

The audit procedure includes -

- (a) Discussion with the management and analysis as to the significance of the fixed assets to the company as a whole
 - (b) Scrutiny of the minutes of the meetings of the board of directors and important committees for understanding the entity's business plans for the future.
 - (c) Review of subsequent events after the balance sheet date for analyzing the effect of such disposal of substantial part of the fixed assets on the going concern.
 - (d) Feasibility of the plans – the auditor should obtain sufficient appropriate audit evidence that the plans of the management are feasible, are likely to be implemented and that the outcome of these plans would improve the situation.
 - (e) The auditor should also seek written representation from the management in this regard.
- (d) Non-Provisions for proposed dividends

Explanation

It is observed, while studying the financial statements of various companies that they do not provide for the proposed dividend and charge the dividend to the profit and loss account as and when its payment is made.

The Council of the ICAI has considered this issue and is of the view that proposed dividend does not represent a liability nor does it amount to a provision, pending the approval of the shareholders in general meeting. The Council is further of the opinion that merely because the prescribed form as given in the schedule VI of the Companies Act, 1956, requires proposed dividend to be shown under 'Current Liabilities and Provisions' it does not mean that in fact the proposal for the dividend becomes a liability or is necessarily a provision. Since, however, the form of balance sheet prescribed under schedule VI part I-A requires, "proposed dividends" to be shown/disclosed, the council is of the opinion that though on correct accounting principles, the proposed dividends does not become a liability, the attention of the shareholders would have to be drawn to the fact that no appropriation has been made for the proposed dividends, the amount in respect of which should be specified.

Recommendation of Council

The council therefore recommends that non-provision for proposed dividends should be disclosed by means of a note in the accounts and that the auditor should refer to the note in his report and make his report subject thereto.

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Question 2.

Comment on the following with reference to the Chartered Accountants Act, 1949 as amended by the Chartered Accountants (Amendment) Act, 2006 and schedules thereto:

- (a) Mr. B, a practicing Chartered Accountant, expressed his opinion on the financial statements of M/s ABC Ltd. for the year ended on 31st March, 2009. It was later found that the closing stock was valued arbitrarily by Management which was accepted by him without verification and large amount of revenue expenditure was capitalised. (5 Marks)
- (b) Mr. A was appointed by H Ltd. to audit the PF trust maintained by the company. While conducting the audit he noticed that large amount of loans have been given out of the trust to the employer company in contravention of the rules of the PF trust. He disclosed the irregularities to the trustees and to the company but not to the individual subscribers of the PF. When queried on his omission to disclose, he explained that he owed no duty to the individual members. (5 Marks)
- (c) Mr. B was appointed as auditor of XYZ Ltd. in place of Mr. A. Mr. B had sent a letter of communication to Mr. A under certificate of posting and proceeds to conduct the audit. Mr. A makes a complaint to the institute on the basis of non-receipt of communication. (4 Marks)
- (d) A Chartered Accountants firm pays share in the profits to a widow of its deceased partner. (4 Marks)

Answer

(a) Explanation

According to the clause (7) of Part - I of the Second schedule to the Chartered Accountants Act, 1949, a member shall be deemed to be guilty of professional misconduct if " he is grossly negligent in the conduct of his professional duties". It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent, careful and cautious auditor would use.

Mr. B. adopted arbitrary valuation of closing stock and accepted the valuation as done by the management without verification. He also failed to point out large amount of revenue expenditure, capitalized, thereby affecting the profitability of the company.

Conclusion

In view of the above, Mr. B. is to be held guilty of gross negligence in the conduct of his professional duties.

(b) Explanation

According to clause (5) of Part-I of the Second schedule of the Chartered Accountants Act, 1949, a member shall be deemed to be guilty of professional misconduct if he "fails to disclose a material fact known to him which is not disclosed in the financial statement,

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but disclosure of which is necessary in making such financial statement not misleading". Further it is no defense for a chartered accountant to say that he had disclosed the irregularities to the company. It is his duty to have made the disclosures thereof to the beneficiaries of the Provident Fund trust also in the statement of accounts signed by him.

Conclusion

In view of the above, his statement that he owed no duty to the individual members is wrong and hence he is guilty of professional misconduct under clause 5.

(c) Explanation

As per clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct if he "accepts a position as auditor, previously held by another chartered accountant, without first communicating with him in writing".

The Council has taken the view that a mere posting of a letter under "Certificate of posting" is not sufficient to establish communication with the retiring auditor unless there is some evidence to show that the letter has, in fact, reached the person communicated with. A chartered accountant who relies upon a letter posted "under certificate of posting". Therefore, does so at his own risk. Merely obtaining a "Certificate of posting" does not fulfill the requirements of clause (8). There should be a positive evidence of the fact that the communication addressed to outgoing auditor by the incoming auditor reached his hands. Certificate of posting of a letter cannot, in the circumstances, be taken as positive of its delivery to the addressee.

Members should therefore, communicate with a retiring auditor in such a manner as to retain in their hands positive evidence of the delivery of the communication to the addressee. In the opinion of the Council, communications by letter sent by Registered post with A.D. or by hand against written acknowledgment would in the normal course provide such evidence.

Conclusion

In view of the above, Mr. A, a retiring auditor, complains about the non-receipt of communication and as Mr. B the incoming auditor, has no positive evidence to prove the delivery of communication to the retiring auditor, he will be held guilty of professional misconduct under clause(8) of Part-I, First schedule.

(d) Explanation

Clause 2, Part I of the first schedule to the Chartered Accountants Act, 1949, is applicable. This clause says that a legal representative or widow of a deceased partner would be entitled to share the profits only where the partnership agreement contains a

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provision that on the death of the partner, his widow or legal representative would be entitled to such payment by way of sharing of fees or otherwise, for some specified period. The widow of a partner, when the partnership agreement does not contain such provision, entitling her to share in profits, would not be entitled to such profits.

Conclusion

In the given case, if such a clause is present in the partnership deed, the sharing is permissible, otherwise not. If no such clause exists, and if the firm still pays share in the profits to a widow of the deceased partner, the firm shall be considered as guilty of professional misconduct.

Question 3.

- (a) State the points in an investigation of frauds through suppliers ledger. (6 Marks)
- (b) State the circumstances that may warrant the introduction of Cost audit. (6 Marks)
- (c) State your views on reference to an expert in the Auditor's report. (4 Marks)

Answer

- (a) Investigation of frauds through suppliers' ledger

The following methods of fraud should be borne in mind:

- (i) Adjusting fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.
- (ii) Suppressing the credit notes issued by suppliers and withdrawing the corresponding amounts not claimed by them.
- (iii) Withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid to them.
- (iv) Accepting purchase invoice at prices considerably higher than their market price and collecting the excess amount paid in cash, from the suppliers.

- (b) Circumstances that may warrant the introduction of cost audit

- (i) Price fixation: The need for fixation of retention price in case of materials of national importance, like steel, cement etc. may be useful in knowing the true cost of production.
- (ii) Cost variation within the industry: Where the cost of production varies significantly from unit to unit in the same industry, cost audit may necessary to find the reasons for such differences.
- (iii) Inefficient management: Where a factory is run inefficiently and uneconomically managed, cost audit may be necessary. It may be particularly useful for the government before it takes over any unit.

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- (iv) Tax-assessment: Where a duty or tax is levied on products based on cost of production, the levying authorities may ask for cost audit to determine the correct cost of production.
 - (v) Trade disputes: Cost audit may be useful in settling trade disputes about claims for higher wages, bonus, etc.
- (c) Reference to an expert in the auditor's report

When expressing an unqualified opinion, the auditor should not refer to the work of an expert in his report.

If, as a result of the work of an expert, the auditor decides to express other than an unqualified opinion, it may in some circumstances benefit the reader of his report if the auditor, in explaining the nature of his reservation, refers to or describes the work of the expert, where-in doing so the auditor considers it appropriate to disclose the identity of the expert, he should obtain prior consent of the expert for such disclosure, if such consent has not been obtained.

Question 4.

- (a) State the internal controls in the area of Loans and Advances of Banks. (12 Marks)
- (b) What shall comprise the auditor's report of Mutual Funds? (4 Marks)

Answer

- (a) Internal controls in the area of loans and advances of banks
- (i) The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from the proper authorities of the bank.
 - (ii) All the necessary documents (e.g. agreements, demand promissory notes, letters of hypothecation etc) should be executed by the parties before advances are made.
 - (iii) Sufficient margin should be kept against securities taken so as to cover any decline in the value thereof and also to comply with Reserve Bank directives. Such margins should be determined by the proper authorities to the bank as a general policy or for particular accounts.
 - (iv) All the securities should be received and returned by responsible officer. They should be kept in the joint custody of two such officers.
 - (v) All the securities requiring registration should be registered in the name of the bank or otherwise accompanied by the documents sufficient to give title to the bank.
 - (vi) In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipts. The godowns should be regularly and frequently inspected by a responsible officer of the branch concerned, in addition by the inspectors of the bank.
 - (vii) Surprise checks should be made in respect of hypothecated goods not in possession of

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the bank.

- (viii) Market value of goods should be checked by officers of the bank by personal enquiry in addition to the invoice value given by the borrowers.
- (ix) As soon as any increase/decrease takes place in the value of securities proper entries should be made in the Drawing Power Book. These entries should be checked by an officer.
- (x) All the accounts should be kept within both the drawing power and the sanctioned limit at all times.
- (xi) All the accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the H.O. regularly.
- (xii) The operation in each advance should be reviewed at least once every year.

(b) Auditor's report of Mutual Funds

The auditor's report of mutual funds shall comprise the following:

- (i) He has obtained all information and explanation which, to the best of his knowledge and belief were necessary for the purpose of audit.
- (ii) The balance sheet and the revenue account give a fair and true view of the scheme, state of affairs and surplus/ deficit in the fund for the accounting period to which the balance sheet or, as the case may be, the revenue account relates.
- (iii) The statement of account has been prepared in accordance with accounting policies and standards as specified in the ninth schedule prescribed by SEBI (MF) regulations, 1996.

Question 5.

- (a) State briefly the Communication/Reporting requirements as per AAS 21 on Non-Compliance in an audit of financial statement: (8 Marks)
 - (i) To the management
 - (ii) To the users of the auditor's report on the financial statements.
 - (iii) To the regulatory and enforcement authorities.
- (b) State the reporting requirement regarding books of account (prescribed, maintained and examined) in Form No. 3CD of Tax Audit under Section 44AB of the Income Tax Act, 1961. (8 Marks)

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Answer

(a) AAS 21 (SA 250): Communication/reporting of non-compliance in an audit of financial statement:

(i) To management

The auditor should as soon as practicable, either communicate with the audit committee, the board of directors and senior management or obtain evidence that they are appropriately informed, regarding non-compliance that comes to the auditor's attention.

If in the auditor's judgment, the non-compliance is believed to be intentional and/or material, the auditor should communicate the finding without delay.

If the auditor suspects that members of senior management including members of the board of directors are involved in non-compliance, the auditor should communicate the matter to the next higher level of authority such as an audit committee or board of directors. Where no higher authority exists or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor may consider seeking legal advice.

(ii) To the users of the auditor's report

If the auditor concludes that the non-compliance has a material effect on the financial statement, the auditor should express a qualified or an adverse opinion.

If the auditor is precluded by the entity from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statement, has or is likely to have occurred, the auditor should express a qualified opinion or a disclaimer of opinion on the financial statements on the basis of a limitation on the scope of the audit.

If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by the entity, the auditor should consider the effect in the auditor's report.

(iii) To regulatory and enforcement authorities

The auditor's duty of confidentiality would ordinarily preclude reporting non-compliance to a third party. However, in certain circumstances that duty of confidentiality is overridden by statute, law or by courts of law (for example, the auditor is required to report certain matters of non-compliance to the Reserve Bank of India (RBI) as per the requirements of Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1988, issued by RBI.

(b) Tax-Audit under section 44 AB of I.T. Act, 1961, Reporting requirements regarding books of account under clause 9 of form - 3CD

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- (i) Whether books of account are prescribed U/S 44 AA, if yes, list of books so prescribed: Books of account may have been prescribed but all these might not have been maintained or produced. Tax auditor should exercise professional judgment and skill as to whether it warrants disclosure or qualification in form no. 3CB or 3CA.
- (ii) Books of account maintained: (In case books of account are maintained in a computer system, mention the books of account generated by such computer system). The tax auditor should obtain a complete list of books of account and other documents maintained (both financial and non-financial) and mark appropriate marks of identification. The list of books of accounts maintained should be given under this clause. As to the requirements regarding mentioning of the books of account generated by the computer system, only such books of account and other records which come within the scope of "proper books of account" should be mentioned and insist on proper print-outs of books of accounts.
- (iii) List of books of account examined: This would constitute the books of original entry and other books of account. While the assessee is to maintain proper evidence in the form of bills, vouchers, documents, etc., it may be noted that these are essential to support the entries in the books of account and no reference to such supporting evidence need to be made under this clause.

Question 6.

- (a) State the audit procedures for verification of outstanding premium and agents' balances of General Insurance companies. (6 Marks)
- (b) When should an auditor make a disclaimer opinion in his Audit report? (5 Marks)
- (c) What are the general principles that propriety audit need to conform? (5 Marks)

Answer

- (a) Audit procedures for verification of outstanding premium and agents' balances of General Insurance Companies

Following are the audit procedures to be followed for verification of outstanding premium and agents' balances.

- (i) Scrutinize and review control account debit balances and their nature should be enquired into.
- (ii) Examine in-operative balances and treatment given for old balances with reference to company rules.
- (iii) Enquire into the reasons for retaining the old balances.
- (iv) Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.

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- (v) Check age-wise, sector-wise analysis of outstanding premium.
- (vi) Verify whether outstanding premiums have since been collected.
- (vii) Check the availability of adequate bank guarantee or premium deposit for outstanding premium.

(b) Disclaimer opinion in audit report

A disclaimer of opinion is expressed when:

- (i) The possible effect of a limitation on the scope is so material and pervasive that the auditor has not been able to obtain sufficient audit evidences and is accordingly unable to express an opinion on the financial statements.
- (ii) A limitation on the scope of the auditor's work may sometimes be imposed by the entity, for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes, is necessary.
- (iii) A scope limitation may be imposed by circumstances, e.g. when the timing of the auditor's appointment is such that he is unable to observe the counting of physical inventories.
- (iv) It may also arise when in the opinion of the auditor, the client's accounting records are inadequate or when he is unable to carry out an audit procedure that he believes, is desirable.
- (v) The resolution on certain matters dependent upon future events, may also cause the auditor to make a disclaimer of opinion.
- (vi) However when the limitation in the terms of a proposed engagement is such that the auditor believes the need to express a disclaimer of opinion exists; the auditor should ordinarily not accept such a limited engagement as an audit engagement unless required by statute. Also a statutory auditor should not accept such an audit engagement when the limitation infringes on the auditor's duties.

When there is a limitation on the scope of the auditor's work that requires expression of a qualified opinion, the auditor's report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary, had the limitation not existed.

(c) General principles of propriety audit

In government accounting, it is observed that instead of too much dependence on documents, vouchers and evidence, more emphasis should be given to the substance of transactions and looks into the appropriateness thereof on a consideration of financial prudence, public interest and prevention of wasteful expenditure.

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Propriety requires the transactions, and more particularly expenditure to confirm to certain general principles. These principles are:

- (i) that the expenditure is not the prima facie more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money,
- (ii) that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage,
- (iii) that the funds are not utilized for the benefit of a particular person or group of persons and
- (iv) that, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

Question 7.

- (a) "When the computer information systems are significant, the auditor should obtain an understanding of the CIS environment and whether it may influence the assessment of inherent and control risk". What factors an auditor has to consider in such risk assessment? (12 Marks)
- (b) In an operational audit performance evaluation, what factors can cause unsatisfactory production performance? (4 Marks)

Answer

- (a) Factors, an auditor has to consider in his understanding of the computer information systems (CIS) environment as well as risk assessment (erstwhile AAS 29)

The nature of the risks and internal control characteristics in CIS environment include the following:

- (i) Lack of transaction trails

Some computer information systems are designed so that a complete transaction trail that is useful for audit purposes might exist for only a short period of time or only in computer readable form. Where a complex application system performs a large number of processing steps, this may not be a complete trail. Accordingly, errors embedded in an application's program logic may be difficult to detect on a timely basis by manual (user) procedures.

- (ii) Uniform processing of transactions

Processing of transactions are done by the same processing instructions. Thus, the clerical errors ordinarily associated with manual processing are virtually eliminated. Conversely programming errors or other systematic errors in hardware or software will ordinarily result in all transactions being processed incorrectly.

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(iii) Lack of segregation of function

Many control procedures that would ordinarily be performed by separate individuals in manual systems may become concentrated in a CIS environment. Thus, an individual who has access to computer programs, processing or data may be in a position to perform incomplete functions.

(iv) Potential for errors and irregularities

Potential for human error in the development, maintenance and execution of CIS may be greater than in manual system.

(v) Initiation or execution of transactions

Computer information systems may include the capability to initiate or cause the execution of certain types of transactions automatically. Management's authorization of these transactions may be implicit in its acceptance of the design of the CIS and subsequent modification.

(vi) Dependence of other controls over computer processing

Computer processing may produce reports and other output, that are used in performing manual control procedures. The effectiveness of these manual control procedures can be dependent on the effectiveness of controls over the completeness and accuracy of computer processing.

(vii) Potential for increased management supervision

CIS can offer management a variety of analytical tool that may be used to review, supervise and enhance entire internal control structure.

(viii) Potential for the use of computer-assisted audit techniques (CAAT)

In case of processing and analysis of large quantitative of data using computers, may require the use of specialized computer audit techniques and tools in the execution of audit tests.

Both the risks and the control introduced as a result of these characteristics of computer information systems have a potential impact on the auditor's assessment of risk, and the nature, timing and extent of audit procedures.

(b) Factors which can cause unsatisfactory production performance in an operational audit performance evaluation

(i) Non-availability of raw materials

(ii) Inadequate or unskilled personnel

(iii) Lack of proper supervision

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- (iv) Lack of proper machine maintenance
- (v) Strikes and/or lock out
- (vi) Problems of power supply
- (vii) Non-availability of essential machine spares
- (viii) Lack of proper quality control
- (ix) Poor quality of raw materials
- (x) Other causes like fire, earthquake etc.

Question 8.

Write short notes on any four of the following:

- (a) Usefulness of careful and adequate audit planning.
- (b) Verification of Margin Deposit Book in the audit of Members of Stock Exchanges.
- (c) Professional Negligence.
- (d) Purposes for which analytical procedures are used by auditors.
- (e) Unqualified opinion in the context of the Auditor's report.
- (f) Assessing the reliability of Audit evidence. (4 x 4 = 16 Marks)

Answer

- (a) Usefulness of careful and adequate audit planning

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Careful and adequate audit planning helps him to:

- (i) Ensure that appropriate attention is devoted to important areas of the audit
- (ii) Ensure that potential problems are promptly identified
- (iii) Ensure that the work is completed expeditiously
- (iv) Utilize the assistants properly and
- (v) Co-ordinate the work done by other auditors and experts

- (b) Verification of margin deposit book

A member is required to maintain a margin deposit book wherein details of all the margins deposited with the Clearing House are to be recorded. The book should be verified to ascertain whether the member has complied with all the directives regarding margins etc. issued by SEBI from time to time. The margin payments made by the members may be cross checked with the daily margin statements downloaded from the Stock Exchange.

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The auditor should apply appropriate audit procedures to satisfy himself that margins have been properly calculated, collected and paid. The auditor should examine that margin deposit lying with the Clearing House are supported by confirmation. The auditor should verify whether adjustment entries relating to settlement margin and daily margin which is adjusted at the time of settlement are correctly passed or not. The auditor should also ensure that exemptions from payment of margins of Institutional Traders have been claimed correctly.

(c) Professional negligence

Negligence, which is culpable, generally consists of under mentioned three elements:

- (i) Existence of duty or responsibility owed by one party to another to perform some act with certain degree of care and competence.
- (ii) Occurrence of a breach of such duty and
- (iii) Loss or detriment, being suffered by the party to whom the duty was owed as a result of negligence.

In this context, professional negligence would constitute failure to perform duties according to "accepted professional standards", resulting in some damage to a party to whom duty is owed.

(d) Purposes for which analytical procedures are used

The main objects are:

- (i) To assist the auditor in planning the nature, timing and extent of audit procedures
- (ii) As a substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions; and
- (iii) As an overall review of the financial statements in the final review, stage of the audit."

(e) Unqualified opinion in the context of the auditor's report

All unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.

An unqualified opinion indicates implicitly, that any changes in the accounting principles or in the methods of their application and the effects thereof, have been properly determined and disclosed in the financial statements.

An unqualified opinion also indicates that:

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- (i) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied
 - (ii) the financial statements comply with relevant statutory requirements and regulations, and
 - (iii) there is an adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.
- (f) Assessing the reliability of audit evidence - AAS 5 (SA 500)
- The reliability of audit evidence depends on its source - internal or external and also on its nature, visual, documentary or oral. The reliability of audit evidence is dependent on the circumstances under which it is obtained. The following generalisations may be useful in assessing the reliability of audit evidence.
- (i) External evidence: It is usually more reliable than the internal evidence e.g. confirmation received from a third party.
 - (ii) Internal evidence: It is more reliable when related internal control is satisfactory.
 - (iii) Evidence in the form of documents and written representations is usually more reliable than the oral representations.
 - (iv) Evidence obtained by the auditor himself is more reliable than that obtained through the entity.