
**PAPER 3: ADVANCED AUDITING
NOVEMBER 2004**

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

Question 1

What are your views on the following?

- (a) A Ltd. was under audit for the year ended 31-03-2004. An appeal filed by A Ltd. against the demand of Excise Duty of Rs. 26 crores was pending before the Supreme Court for which neither provision was made nor disclosed in the notes to the financial statements. On 12th July, 2004, the auditor came to know through paper reports that the point involved in the appeal of A Ltd. was adjudicated by the Supreme Court in the case of some other assessee; which is in favour of the department of Excise Duty. The auditor insisted that provisions be made of Rs.26 crores in the financial statements. The Management was of the view that since its own case is still pending, no provision is called for. It was also of the view that the event does not have any effect on the financial position of the company on the date of the Balance sheet. Is the view of the Management tenable? **(5 Marks)**
- (b) Kevin Industries Ltd. has paid up capital of Rs. 20 crores dividend into equity shares of Rs. 10 each as on 31-03-2003. During the financial year 2003-04 it has issued bonus shares in the ratio 1:1. The net profit after tax for the years 31-3-2003 and 31-3-2004 is Rs.10 crores and Rs.15 crores respectively. The Earnings per share (EPS) disclosed in the financial statements for the above two years is Rs.5.00 and Rs.3.75 respectively. Is the disclosure correct? **(5 Marks)**
- (c) An auditor of Sagar Ltd. was not able to get the confirmation about the existence and value of certain machineries. However the management gave him a certificate to prove the existence and value of the machinery as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach? **(5 Marks)**
- (d) A firm of a father and a son is receiving Rs. 2 lakhs towards job work done for XYZ Ltd. during the year ended on 31-03-04. The total job work charges paid by XYZ Ltd. during the year are over Rs.50 lakhs. The father is a Managing Director of XYZ Ltd. having substantial holding. The Managing Director told the auditor that since he is not involved in activities of the firm and since the amount paid to it is insignificant; there is no need to disclose the transaction. He further contended that such a payment made in the last year was not disclosed. Is the Managing Director right in his approach? **(5 Marks)**
- (e) Do you approve of the following? If not, why?

Question 2

Do you approve the following? If not, why?

- (a) A firm of Chartered Accountants was appointed by a company to evaluate the costs of the various products manufactured by it for its information system. One of the partners of the firm was a Non-Executive Director of the company. **(4 Marks)**
- (b) Mr. Qureshi, Chartered Accountant, in practice died in a road accident. His widow proposes to sell the practice of her husband to Mr.Paradeshi, Chartered Accountant, for Rs.5 lakhs. The price also includes right to use the firm name – Qureshi & Associates. Can widow of Qureshi sell the practice and can Mr. Pardeshi continue to practice in that name as a proprietor? **(4 Marks)**
- (c) Trimurthy Pan Masala (P) Ltd. was incurring heavy losses in the last several years since it could not withstand the competition in the market. The State in which the company had its registered office and also its major sales had moved a bill in the State Assembly to ban manufacture and sale of all kinds of Pan Masala in the State. While finalizing the accounts for the year ended 31-03-2004, the CFO of the

company created a Deferred Tax Asset for the tax benefits that would arise in future years from the earlier years losses that had remained unabsorbed in Income Tax. **(4 Marks)**

- (d) Big Ltd. has borrowed Rs. 30 lakhs from State Bank of India during the financial year 2003-04. The borrowings are used to invest in shares of Small Ltd., a subsidiary company of Big Ltd., which is implemented a new project estimated to cost Rs. 50 lakhs. As on 31st March, 2004, since the said project was not complete, the directors of Big Ltd. resolved to capitalize the interest accruing on borrowings amounting to Rs. 4 lakhs and add it to the cost of investments. **(4 Marks)**

Question 3

- (a) What are 'Initial Audit Engagements'? **(2 Marks)**
- (b) In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow in cases (i) when the financial statements are audited for the preceding period by another auditor; and (ii) when financial statements are audited for the first time. **(7 Marks)**
- (c) If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances'; what approach you will adopt in drafting your audit report in two situations mentioned in (b) above? **(7 Marks)**

Question 4

- (a) Enumerate the 'Basic Elements of Audit Report' as enshrined in AAS-28. **(8 Marks)**
- (b) Bring out the significance of the following two illustrative paragraphs found in the statutory auditors in recent days.
- Opening Paragraph:
"We have audited the attached Balance Sheet of..... as at 31st March, 2××× and also the Profit and Loss Account for the year ended on that date annexed thereto. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements." **(4 Marks)**
 - Scope Paragraph:
"We conducted our audit in accordance with the auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material statement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial presentation. We believe that our audit provides a reasonable basis for our opinion". **(4 Marks)**

Question 5

- (a) State the specific problems, which may arise in the implementation of internal control in an EDP system. **(8 Marks)**
- (b) What are the characteristics of 'On-line Computer System'? **(4 Marks)**
- (c) Explain: Tagging and Tracing. **(4 Marks)**

Question 6

- (a) You have been appointed Management Auditor of a large manufacturing company suffering from working capital crunch. Enlist and discuss the related areas which you would probe into to overcome the company's problem. **(8 Marks)**

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- (b) Miranda Spinning Mills Ltd. is a sick company and has accumulated losses of Rs. 10 crores. The company has Rs.12 crores in its Share Premium Account. The Management desires to adjust the accumulated losses against the share premium balance. Advise the Company giving your reasons. **(4 Marks)**

Question 7

- (a) Section 274 of the Companies Act, 1956 is applicable to appointment of Directors. Briefly explain your duty as a statutory auditor in this connection. **(8 Marks)**
- (b) A company has paid interim dividend at 10% based on its half-yearly performance while at the end of the year suffered a net loss. How you will deal with the matter in your audit report as a statutory auditor? **(4 Marks)**
- (c) State the procedure for verification of Agents' Balances in the course of audit of a General Insurance Company. **(4 Marks)**

Question 8

Write short notes on the any **four** of following:

(4×4=16 Marks)

- (a) 'Certificate for special purpose' vs. 'Audit Report'
- (b) 'Audit' vs. 'Investigation'
- (c) Sauda Book
- (d) Other Misconduct
- (e) Advantages of 'Cost Audit' to Govt.
- (f) Principal Enactments Governing Bank Audit
- (g) Corporate Governance
- (h) Responsibility of Joint Auditors.