CA Final May 15
Paper Analysis

By CA Ravi Taori

For Video on Paper Analysis visit www.youtube.com/ravitaori

CA Final May 15 Audit Paper was bang on target as expected, New Company's Act was asked for 20 Marks, Standards on Auditing for 36 and Professional Ethics for 16.

Some questions were tricky, reading question twice & carefully was must.

- As usual students with in-depth knowledge, fine writing skills and those who covered all topics will score very good marks.

Question 1(a)

Compulsory /Standards on Auditing **(5M)**

As an auditor of RST Ltd. Mr. P applied the **concept of materiality** for the financial statements **as a whole.**

On the basis of obtaining **additional information of significant contractual arrangements** that draw attention to a particular aspect of a company's business, he wants to **re-evaluate the materiality concept.** Please guide him.

Answer of Question 1(a)
Compulsory /Standards on Auditing **(5M)**

-Refer SA 320

-Explain Concept of Materiality (1 Line)

-Explain Materiality at Financial Statement as a Whole V/s Materiality at Transaction / Balance Level (1 Line)

-Revision of Materiality (FOCUS of the answer)

Para 12-13

Materiality is decided at planning stage and if additional information is received it can be revised.

If it results in lower materiality of financial statement as a whole or at transaction or account balance level then we may have to revise performance materiality and NTE of audit procedure.

Example of Truck Manufacturing Company Planning Materiality for Financial Statement as a Whole, **Turnover 1000 Crore x 0.5 % = 5 Crores** and **Performance Materiality 5 Crores x 80 % = 4 Crores**

Government contract for manufacturing defence trucks, strict specifications / cost / time restrictions otherwise huge penalties and separate disclosure in financial statements "Make in India". Further in past there used to be many errors and frauds in defence contracts we should set lower materiality, so lower **performance materiality 5 X 60% = 3 Crores for defence contracts.**

Question 1(b)
Compulsory /Standards on Auditing **(5M)**

The financial statements of TC & Co. have been prepared by management of an entity in accordance with the financial reporting provisions of a contract (that is a special purpose framework) to comply with provisions of the contract. Based on the contract, management does not have a choice of financial reporting frameworks.

As an auditor what considerations would be undertaken while planning and performing audit ?

Answer of Question 1(b) Compulsory /Standards on Auditing **(5M)**

-Refer SA 800

-Explain Special Purpose Framework (1 Line)

-Before acceptance we should understand purpose / Suitability of FRF for purpose & Is organization policy & system in line with FRF (2 Lines)

-Planning & Performing such assignment

(FOCUS of the answer) Para 9 & 10

-Check applicability of all SAs from 200 to 700, if SAs are not relevant ignore them or change requirements E.g. Format of Engagement Letter may be different "SA 210"/ Materiality may be agreed with appointing authority "SA 320" / Communication may be defined with TCWG "SA 260"

-Understanding entity & its environment

-Understand FRF requirements (Special Purpose)

-Significant Interpretations

-Arrange required team equipments & experts

-Special purpose FRF should be explained in notes to accounts & EMP paragraph "Basis of Accounting" should be inserted in Audit Report

Question 1(c)
Compulsory /Standards on Auditing **(5M)**

When subservice organisation performs services for a service organization, **there are two alternative methods of presenting the description of controls.** The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization ?

Answer Question 1(c)
Compulsory /Standards on Auditing **(5M)**

-Refer SA 402

-Explain Service Organisation & Sub Service Organisation

-Explain Type 1 & Type 2 Report

-**2 Alternatives with respect to Sub Service Organisation, Inclusive Report or Carve Out Report Para 18**

-**(FOCUS of the answer)**

-What if exclusive report is obtained ?

Question 1(d)

Compulsory /Standards on Auditing **(5M)**

In an initial audit engagement the auditor will have to satisfy about the sufficiency & appropriateness of <u>'Opening Balances'</u> to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow, when financial statements are audited for the first time. 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 ?

Answer Question 1(d)
Compulsory /Standards on Auditing **(5M)**

-Refer SA 510

-When is SA 510 applicable / Objectives of SA 510

-**How to check opening balances**

(FOCUS of the answer) 5-6 points

-Important to mention about consistency of accounting policy

-What is there is no sufficient or appropriate evidence or misstatement ?

-OMP

Question 2(a)

Standards in Auditing(**6 M**)

As an auditor of garment manufacturing company for the last five years you have observed that new venture of online shopping has been added by the company during current year. As an auditor what factors would be considered by you in formulating the audit strategy of the company ?

Question 2(a)

Standards in Auditing**(6 M)**

Audit strategy is concerned with designing optimised audit approaches that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available.

(i) Obtaining Knowledge of Business

(ii) Performing Analytical Procedures

(iii) Evaluating Inherent Risk

(iv) Evaluating Internal Control

Question 2(a)
Standards in Auditing(**6 M)**

ENVIRONMENTAL RISKS

Competitor Industry

Legal / Regulatory

Tax

Capital Availability

Political

PROCESS RISKS

Operations Risk

Human Resources

Customer Service

Privacy of Data Protection

Intellectual Property

Transaction Authenticity

Business Interruption

Fraud

Technology Risk

Selection

Development

Integration

Availability & Continuity

Capacity & Scalability

Records Management

Financial Risk

Pricing

Currency

Cash Flow

Question 2(b)

Consolidation **(6 M)**

A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd., what factors would be considered by you for audit of financial statements ?

Answer

-Refer Sec 129 & AS 21

-Consolidation will take place in A Ltd also and if other company holds more than 50% then there also

Responsibilities of Auditor / Audit of Consolidation

1.Determine can we accept role of principal auditor as per SA 600 before accepting audit.

2.Establish co-ordination with auditors component and advise them as per SA 600.

3.Identify components & understand its relation (Subsidiary / Associate / Joint Venture)

4.Understand nature of business of whole group

5.Understand Internal Control System over consolidation process

6.Identify Risks

7.Apply Guidance Note on Consolidation

8.Check compliance of AS 21 / 23 / 27

9. Check permanent consolidation adjustment from opening & previous consolidated financial statements

10. Check Current Consolidation Adjustments
11. Check disclosure requirement of schedule III , explaining percentage of profits & percentage of net assets from components

12. Take written representation regarding management responsibility , completeness of components, segment reporting, related party transactions & adjustments

13. Other Matter Paragraph
    The auditor's report on consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). This may be done by stating the rupee amounts or percentages of total assets and total revenue of subsidiary(s) included in consolidated financial statements not audited by the parent's auditor

OTHER MATTERS

6. Financial statements / consolidated financial statements of certain subsidiaries which reflect total assets (net) of Rs 81,533 crore as at March 31, 2014, total revenue (net) of Rs 52,452 crore and net cash flows amounting to Rs 67 crore for the year then ended, have been audited **by one or jointly by two of us or one of us with other and financial statements of an associate in which the share of profit of the Group is Rs 11 crore have been audited by one of us.**

7. We did not audit the financial statements / consolidated financial statements of certain subsidiaries whose financial statements / consolidated financial statements reflect total assets (net) of Rs 48,602 crore as at March 31, 2014/ December 31, 2013, total revenues (net) of Rs 19,065 crore and net cash flows amounting to Rs 384 Crore for the year ended on that date and financial statements of an associate in which the share of profit of the Group is Rs 1 crore. These financial statements / consolidated financial statements have been audited by other auditors whose reports have been furnished to us and our opinion is based solely on the reports of the other auditors.

8. **We have relied on the unaudited financial statements** of certain associates wherein the Group's share of profit aggregate Rs 15 crore. These unaudited financial statements as approved by the respective Boards of Directors of these companies have been furnished to us by the Management and our report insofar as it relates to the amounts included in respect of associates is based solely on such approved unaudited financial statements. Our opinion is not qualified in respect of other matters

Question 2(c)

Sarbanes Oxley **(4M)**

Write short note on - Corporate Responsibility under Sarbanes and Oxley Act.

Answer

Corporate Responsibility under Sarbanes Oxley Act of 2002 : The Sarbanes–Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 is a United States federal law passed in response to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, and WorldCom. The act contains eleven titles and establishes corporate accountability and civil and criminal penalties for white – collar crimes. The title three deals with the Corporate Responsibility which is as follows:

(i) The audit committee to be more independent through enhancement of their over sight responsibilities and one of the Audit committee members to be financial expert.

(ii) Requires CEO & CFO to issue certification of the quarterly financial results and annual reports to SEC as part of compliance with Form 10K.

(iii) Provides rules of conduct for companies managerial and their officers regarding Pension matters.

(iv) To Comply with SEC rules requiring attorneys to report violation of securities to the company's CEO or Chief Legal Counsel and to Audit Committee if no action is taken.

Question 3(a)

Schedule III **(4M)**

MG & Co. Ltd. seeks your advice while preparing financial statements the general instructions to be followed while preparing Balance Sheet under Companies Act, 2013 in respect of current assets and current liabilities.

Answer

Define Current Assets & Current Liabilities

Contents of Current Assets & Liabilities with Examples

Question 3(b)
Company Audit **(4M)**

C.A. Ashwin was appointed as auditor of Bristol Ltd. for the year 2013-14.

Since he declined to accept the appointment, the Board of Directors appointed CA John as the Auditor in place of C.A. Ashwin and the appointment was accepted by C.A. John. Discuss.

Answer

First of all it is wrong question because in new act there is no concept of post appointment acceptance but there is concept of pre appointment acceptance. It is question of old company Act 1956.

Refer Section 139 of Company Act.

Explain concept of automatic reappointment , explain concept of consent, Explain Concept of Casual Vacancy.

Here it is kind of resignation so BOD can appoint but it needs to be approved within 3 months by shareholders.

Question 3(c)
Bank Audit **(4M)**

During the bank audit AB & Co. a new Chartered Accountant firm. observed the sale/purchase of NFAs. Please help them by narrating the aspects, relating to sale/purchase of NPAs, to be considered.

Answer

Explain Sale / Purchase of NPAs by Banks

AUDIT OF SALE/ PURCHASE OF NPAs:

In case of a sale/ purchase of NPAs by the bank, the auditor should examine the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers.

1. The auditor should also examine that:
2. Only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
3. The assets have been sold/ purchased "without recourse' only.
4. Under no circumstances can a sale to other banks be made at a contingent price
5. Subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
6. The NPA has been sold at cash basis only.
7. In case of sale of an NPA, the auditor should also ensure that:
   a. On the sale of the NPA, the same has been removed from the books of the account.
   b. The short fall in the net book value has been charged to the profit and loss account.
   C. Where the sale is for a value higher than the NBV, no profit is recognised and the excess provision has not been reversed but retained to meet the shortfall/ loss on account of sale of other non-performing financial assets.

<u>AUDIT OF SALE/ PURCHASE OF NPAS</u>:

Further in case of purchase of NPAs, the auditor should verify that:
The bank has not purchased an NPA which it had originally sold.
1. A non-performing financial asset should be held by the **purchasing bank in its books at least for a period of 15 months** before it is sold to other banks. Banks should not sell such assets back to the bank, which had sold the NPFA.

2. The non-performing financial asset purchased, **may be classified as 'standard' in the books of the purchasing bank for a period of 90 days from the date of purchase.** Thereafter, the asset classification status of the financial asset purchased, shall be determined by the record of recovery in the books of the purchasing bank

3. The NPA purchased has been subjected to the provisioning requirements appropriate to the classification status in the books of the purchasing bank.

4. Any recovery in respect of an NPA purchased from other banks is first adjusted against its acquisition cost and only the recovered amount in excess of the acquisition cost has been recognised as profit.
5. For the purpose of capital adequacy, banks has assigned 100% risk weights to the NPAs purchased from other banks.

Question 3(d)
Guidance Note **(4M)**

Under the Payment of Bonus Act, 1965. a 'report' on the computation of bonus payable.

Answer

Chartered Accountant certificate regarding employers' bonus computation:

"We have reviewed the figure in the above computation, in comparison with the books and records of X Company Limited, produced to us, the audit of which has already been completed by us or another firm of chartered accountants and report that, subject to the notes given on the face of computation, in our opinion, and to the best of our knowledge and belief and according to the information and explanations given to us, the above computation is in due accordance therewith and has been made on a basis reasonably consistent with the provisions of the Payment of Bonus Act, 1965."

Question 3(d)
Mutual Fund **(4M)**

Auditor's Report in accordance with Regulation 54 of the SEBI (Mutual Fund) Regulation, 1993.

Answer

Another blunder by ICAI, SEBI regulation 1993 were replaced by SEBI Regulations 1996

Question 3(d)
Mutual Fund **(4M)**

55. (1) Every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company.

(2) An auditor shall be appointed by the trustees.

(3) The auditor shall forward his report to the trustees and such report shall form part of the Annual Report of the mutual fund.

(4) The auditor's report shall comprise the following:—

(a) a certificate to the effect that,—

(i) he has obtained all information and explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit ;

(ii) the balance sheet and the revenue account give a fair and true view of the scheme, state of affairs and surplus or 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.

Question 4(a)
Company Audit **(6M)**

R and M is an audit firm having partners CA R, CA M and CA G. Mr. S is the relative of CA R holding shares of STP Ltd. having a face value of ? 1.51,000. Whether CA R and CA M are qualified to be appointed as auditors of STP Co. ?

Answer

-Refer Section 143 (3) of Companies Act

-Explain disqualifications because of securities / indebtedness / guarantee

-In case of relatives there is exemption up to FV of Rs 1,00,000

-But here face value held by relatives is Rs 1,51,000 that means CA R is disqualified and if CA R is disqualified then automatically firm R and M will be disqualified.

Question 4(b)

Standards on Auditing **(6M)**

As an auditor, during your interim visit at Marathon Ltd. you observed that internal controls were not in use throughout the period covered under audit. What are the controls objectives you would like to consider to achieve your purpose ?

Question 4(b)
Standards on Auditing **(6M)**

Basic Accounting Control Objectives

(i) Whether all transactions are recorded;

(ii) Whether recorded transactions are real;

(iii) Whether all recorded transactions are properly valued;

(iv) Whether all transactions are recorded timely;

(v) Whether all transactions are properly posted;

(vi) Whether all transactions are properly classified and disclosed;

(vii) Whether all transactions are properly summarized.

Question 4(c)

Consolidation **(6M)**

Parent Ltd. acquired 51% shares of Child Ltd. during the year ending 31-3-2014. During the financial year 2014-15 the 20% shares of Child Ltd. were sold by Parent Ltd. Parent Ltd. while preparing the financial statements for the year ending 31-3-2014 and 31-3-2015 did not consider the financial statements of Child Ltd. for consolidation. As a statutory auditor how would you deal with it ?

Question 4(c)
Consolidation **(6M)**

Answer

Assuming it is listed company

-Refer & Explain Section 129 which asks for consolidation

-Refer AS 21 which talks about consolidation of subsidiary with line by line method of consolidation

-Refer AS 23 which talks about consolidation of associate with equity method of accounting.

-Also explain exemption from consolidation

1. Temporary Holding 2. No Economic Benefit

-**We have to see year end % holding for consolidation**

-**In present is exemptions are not applicable then consolidation should be done in FY 13-14 as per AS 21 but in FY 14-15 it should be done as per AS 23**

Question 5(a)
Professional Ethics **(4M)**

Mr. SP, a Chartered Accountant obtains registration as category IV Merchant Banker under the SEBI's Rules and Regulations and act as Advisor to a capital issue of MB Co. Ltd. He designates himself under the caption “Merchant Banker” in client offer documents and ‘Advisor to issue’ in his own letterheads, visiting cards and professional documents.

Answer to Question 5(a)
Professional Ethics **(4M)**

-Refer "Schedule I, Part 1, Clause 7" of CA Act 1949

-Also refer Section 7 of CA Act 1949

-Explain designation requirement when CA is in Practice & When he is not in practice

-In present case Chartered Accountant is doing financial consultancy that means he is in practice, so he can use only "Chartered Accountant" as designation

-Further as per clarification of ICAI as given in Code of Ethics 2009, CA can get registered as Merchant Banker under Category IV but in offer document he can be referred as " Adviser to issue" not merchant banker.

So Final Conclusion is in offer document he can be referred as "Adviser to Issue" and on Visiting Card & Other official documents he should have designation " Chartered Accountant" Hence he is guilty of professional misconduct.

Question 5(b)
Professional Ethics **(4M)**

A Chartered Accountant having COP entered into partnership with persons, who are not the members of the institute, for the purpose of carrying on business.

The share of the chartered account in the profit and losses was 25%. He was to take part in the business and was entitled to represent the firm before Govt, authorities etc. He was operating the bank account of the firm was receiving moneys from the customers and was also looking after the affairs of the partnership.

Answer to Question 5(b)
Professional Ethics **(4M)**

-Refer "Schedule I, Part I, Clause 4 & Clause 11" of CA Act 1949

-Explain that CA in practice can enter into partnership with only with "CA in practice / Foreign professional under MOU (Resident without India) / Prescribed members of foreign professional bodies

-Explain that CA in practice cannot enter into any other business or profession except under "General Permission / Specific Permission"

-In this case he has violated Clause 4 as well as Clause 11 hence he is guilty of professional misconduct

Question 5(c)
Professional Ethics **(4M)**

CA SG a practicing CA agreed to select and recruit personnel, conduct training program for and on behalf of the client.

Answer

Refer to "List of Management Consultancy Services issued under Section 2(2)(iv)"

Explain such activities can be carried by CA in Practice, It will be considered CA related work.

"Selection / Recruitment & Training" is covered under MCS, so he can perform all these activities" He is not guilty of professional misconduct.

Question 5(d)
Professional Ethics **(4M)**

Mr. P a practicing chartered accountant acting as liquidator of AB & Co. charged his professional fees on percentage of the realization of assets.

Answer

Refer "Schedule I, Part 1, Clause 10"

Explain CA in practice cannot charge fees which is contingent, depends on outcome / result of service or percentage basis.

But there as few exceptions "Liquidation / Co-operative Society Audit/ Valuation under tax law / determined by court"

Present case is covered under exception so he is not guilty of professional misconduct

Question 6(a)
Company Audit **(4M)**

The auditor report of company states that proper books of accounts as required by law have been maintained by the company. What is the role of statutory auditor of the company, when a company be said to have not maintained proper books of account ?

Answer to Question 6(a)
Company Audit **(4M)**

-Refer Section 128 & Section 143 of Company Act 2013 & SA 705

-Explain Sec 128 says Proper Books of Accounts should be maintained at register office.

-Explain contents of books of accounts Receipts & Payments / Sales & Purchases / Assets & Liabilities / Cost Records if required

-Explain requirements of Proper Books of Accounts:- Accrual / Double Entry / True & Fair view

-Explain Sec 143 explicitly asks to comment whether books of accounts are proper

Answer to Question 6(a)
Company Audit **(4M)**

-If books are not proper Sec 128 is contravened and auditor has to report as per Sec 143 in his audit report along with reason that why books of accounts are not proper.

-If books of accounts are not proper & if it results into MMST then auditor may have to qualify or give adverse opinion as per SA 705

Question 6(b)

TAX Audit **(4M)**

Comment with respect to computation of total sales, turnover or gross receipts in business exceeding the prescribed limit under Section 44 AB of Income Tax Act, 1961 and VAT law.

(i) Discount allowed in the sales invoice

(ii) Cash discount

(iii) Price of goods returned related to earlier year

(iv) Sale proceeds of fixed assets

Answer to Question 6(b)

TAX Audit **(4M)**

-Refer to Sec 44AB & Guidance Note on TAX Audit

-Explain 4 clauses of Sec 44AB

-Explain Guidance Note on Tax Audit explains what should be included excluded

-Discount allowed in sales invoice by whatever name it is called is in nature of trade discount and it should be reduced while computing Turnover. (In case of VAT if it is a regular discount)

-Cash discount which is allowed after sales for early recovery of money is not reduced while computing turnover. (Same treatment in VAT)

-Price of goods returned related to earlier year is nothing but sales return it is a regular feature that sales of one year may be returned in next year, it is allowed as deduction from turnover (If return happens within specified period E.g. in Maharashtra VAT it is 6 months)

Answer to Question 6(b)

TAX Audit **(4M)**

-Sale of Fixed Assets is not of revenue hence it should be excluded from determining turnover.(Incase of VAT it may differ from state to state in Maharashtra VAT is payable on Fixed Assets hence it should be included)

Question 6(c)
Peer Review **(4M)**

Explain the stepwise approach adopted by the Peer reviewer.

Answer

Explain concept of Peer Review

Give reference of Statement on Peer Review

Explain 3 Stages in detail

Stage 1:- Selection & Planning

Stage 2:- Execution

Stage 3:- Reporting (Preliminary & Final Report)

Question 6(d)
Company Audit **(4M)**

AB Pvt. Ltd. company having outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint internal auditor. Please guide him who can be appointed as internal auditor and what would be reviewed by him.

Answer

-Reference of Sec 138 of Company Act

-Explain provisions for applicability of Internal Audit, limit for borrowing from banks is 100 crore & turnover is 200 crore both for private and public company some extra points are there for public company.

-So in given case internal audit is applicable.

-Further practicing CA / CMA / Any such Other Professional can do internal audit, may or may not be employee of company.

-Give definition of internal audit & explain that scope decide by board of directors.

Question 7(a)

NBFC **(4M)**

CORE INVETMENT COMPANY

Answer

1. It is NBFC

2. Define Investment Company

3. Regulated by RBI

4. CORE Investment Company Criteria

Not Raising Public Deposits / Invests in particular business group (E.g. TATA Sons) / At least 90% in one group / At least 60% in equity shares / No trading in securities / Only block sale / If it is systematically important core investment company where asset size in 100 crore or more then registration is compulsory

Question 7(b)
INSURANCE **(4M)**

Investible Funds as defined by IRDA

Answer

"Investible Funds" is unexpected terminology, not covered in module, practice manual or any book. This word was used only once in KPN Committee anyways what I think it means is "Investment Assets".

Every General Insurance company has to keep specified % on "Investment Assets" in particular type of securities.

Question 7(b)
INSURANCE **(4M)**

(i)Government Securities - Not less than 20% of Investment Assets

(ii)Government Securities and other approved securities - Not less than 30% of Investment Assets (including (i) above)

(iii) (a) Approved investments and other investments - Not exceeding 55%

(Other investments shall not exceed 25% of Investment)

(b)Housing and Loans to State Government for Housing & Fire Fighting Equipment - Not less than 5%

(c) Investment in infrastructure - Not less than 10%

Question 7(b)
INSURANCE **(4M)**

All these percentage are to be applied on "Investment Assets"

Now what do you mean by investment assets in case of general insurance company is share holders fund only to the extent of solvency margin & policy holders fund.

That means share holders fund apart from solvency margin such as share capital, loan raised, free reserves can be invested as determined by insurance company.

Question 7(c)
Investigation & Due Diligence **(4M)**

Areas in which due diligence can take place

Answer

Discipline-wise it can be classified as follows:

- **Legal Due Diligence**
- **Commercial / Operational Due Diligence**
- **Personnel Due Diligence**
- **Financial Due Diligence**
- **Tax Due Diligence (Direct and Indirect)**
- **Information System Due Diligence**
- **Environmental Due Diligence**

Question 7(d)

Management & Operational Audit **(4M)**

Operational auditing arose from the need of managers responsible for areas beyond their direct supervision.

Answer

The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company where the management is at a distance from actual operations due to layers of delegation of responsibility, separating it from actualities in the organisation. Specifically, operational auditing arose from the need of managers responsible for areas beyond their direct observation to be fully, objectively and currently informed about conditions in the units under control.

These conventional sources fail to provide information for the best direction of the departments all of whose activities do not come under direct observation of managers. The shortcomings of these sources can be stated as under:

(i) Executives and managers are too preoccupied with implementation of plans and achieving of targets. They are left with very little time to collect information and locate problems. They may come across problems that have come to surface but they are hardly aware of problems that are brewing and potential.

(ii) Managers or their aides are generally relied upon for transmitting information than for booking for information or for analysing situations.

Question 7(d)

Management & Operational Audit **(4M)**

(iii) The information that is transmitted by managers is not necessarily objective - often it may be biased for various reasons.

(iv) Conventional internal audit reports are often routine and mechanical in character and have a definite leaning towards accounting and financial information. They are also historical in nature.

(v) Other performance reports contained in the annual audited accounts and the routine reports prepared by the operating departments have their own limitations.

For example, the routine weekly production report may include production 'that is subsequently rejected by the quality control staff, or to avoid showing a bad production performance; even the partly produced goods may also be included. Remember, all this can happen inspite of specific management instructions about the basis on which the production report is to be made out.

(vi) Operations of controls in a satisfactory manner cannot be relied upon to bring to light the environmental conditions. Controls are specific and their satisfactory operation is related to the specific situation under control. Also monitoring of the breakdown or non-operation of controls is a periodic phenomenon.

(vii) Surveys and special investigations no doubt are very useful but these are at the best occasional in character. Also, they are costly, time consuming and keep the departmental key personnel busy during the period they are on.

Question 7(e)
Standards of Auditing **(4M)**

"Review of the internal audit function has become statutory responsibility for the statutory auditor.'

Answer

-Refer SA 610 / CARO / Sec 138

-Explain common points between statutory audit & internal audit

-Explain work of internal audit can be useful for us and it can reduce time & cost and improve quality.

-SA 610 says if internal audit covers controls relevant for audit, statutory auditor can evaluate internal auditor and audit work and rely on it. But it is not statutory compulsion.

-Further CARO 2003 specifically asked to comment on adequacy of internal audit of specified companies but CARO 2015 is not having this clause

-Sec 138 which deals with does not mention any such thing

So end conclusion is it is not statutory requirement to review and comment but it can help auditor in doing his work.