

PAPER – 2 : AUDITING

Answer **all** the questions

Question 1

As an Auditor, comment on the following:

- (a) Gear Ltd. is engaged in manufacturing and supply of gear boxes to Indian Automobile Ltd. As per terms of supply, full price of the goods are not released by Indian Automobile Ltd. but 10% thereof is retained and paid after one year, if there is satisfactory performance of the parts supplied. Gear Ltd. accounts for only 90% of the invoice value as sale at the time of supply and balance 10% is accounted as sale in the year of receipt of payment. (5 Marks)
- (b) Board of Directors of Natraj Ltd. wants to transfer an amount of Rs.31.50 lacs lying in unpaid dividend account to their Profit and Loss account on the plea that it is 3 years old and no shareholder is expected to turn up and claim the same. (4 Marks)
- (c) Lehar Ltd. installed a new water treatment plant at its factory on 1.10.2007. The company estimated that the new plant will become obsolete after 4 years only and hence charged depreciation at a rate higher than that envisaged in Schedule XIV to the Companies Act. During the year 2007-08, the company therefore had written off 1/4th of the cost. (5 Marks)
- (d) Fire Ltd. purchased equipment for its power plant from Urja Ltd. during the year 2006-07 at a cost of Rs.100 lacs. Out of this they paid only 90% and balance 10% was to be paid after one year on satisfactory performance of the equipment. During the Financial year 2007-08, Urja Ltd. waived off the balance 10% amount which was credited to Profit and Loss account by Fire Ltd. as discount received. (4 Marks)

Answer

- (a) According to AS-9 on Revenue recognition, revenue from sale of goods should be recognised when the seller has transferred to the buyer, the property in the goods for a price or when the seller has transferred all significant risk and rewards and the seller retains no effective control over goods and no significant uncertainty exists regarding the amount of consideration and its collectibility.

In the given case the goods as well as the risk and ownership has been transferred by Gear Ltd., to Indian Automobile Ltd., on the basis of invoice and delivery of material.

In the instant case, therefore, Gear Ltd., should recognise sale at full 100% of the invoice value in spite of the fact that 10% payment will be released after one year. However, depending upon the past experience regarding collectibility of 10% amount, they can make a provision for the amount that is not likely to be realised.

Hence, the treatment given by the company is not correct and if they do not correct it, the auditor should qualify his report.

- (b) According to Section 205A, of the Companies Act, 1956 it is compulsory for a company to transfer the amount of dividend, which remains unpaid or unclaimed within 30 days of the declaration, to a special bank A/c to be opened in any scheduled bank.

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Furthermore, if the money so transferred to the unpaid dividend remains unclaimed for a period of seven years from the date of such transfer, such money should be transferred to Investor Education and Protection Fund established under Section 205C of the Act.

In the instant case, action of the company in transferring the amount after 3 years from unpaid dividend A/c to Profit & Loss Account is non-compliance of the section and may invite imprisonment and/or fine.

The auditor should advise the board of directors of Natraj Ltd., not to transfer the said amount to its Profit & Loss Account in violation of section 205A and if the board of directors does not agree, he should qualify his report.

- (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 Lehar 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 2007-08 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) According to AS-10 on Accounting for Fixed Assets, the cost of an asset may undergo changes subsequent to its acquisition on account of exchange fluctuation, price adjustment, changes in duty or similar factors. Such changes in price /cost needs to be adjusted with the cost of the asset.

In the give case, Fire Ltd., initially accounted for 100% amount i.e., Rs.100 lacs as cost of fixed asset although they paid only Rs.90 lacs and kept Rs.10 lacs as payable to the credit of Urja Ltd. Now since the supplier has waived off the balance amount of Rs.10 lacs, this should be treated as change in price and needs to be adjusted with the cost of asset as per AS-10.

Therefore, the treatment given by Fire Ltd., in crediting Rs.10. Lacs as discount to Profit & Loss Account is completely wrong and needs to be corrected. It will have effect on depreciation also and needs adjustment.

The auditor should report the matter if suitable changes are not made in the accounts.

Question 2

Give your comments on the following:

- (a) *Hum & Tum Associates, Chartered Accountants, have been appointed as auditors of SP Ltd. Mr. Tum, a junior partner, holds 10 shares of HP Ltd., which is holding company of SP Ltd. (5 Marks)*

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- (b) *Mr. Budha, Statutory Auditors of Secret Ltd. was not permitted by the Board of Directors to attend general meeting of the company on the ground that his right to attend general meetings is restricted only to those meetings at which the accounts audited by him are to be presented and discussed.* (4 Marks)
- (c) *M/s Young & Co., a Chartered Accountant firm, and Statutory Auditors of Old Ltd., is dissolved on 1.2.2008 due to differences of opinion among the partners. The Board of Directors of Old Ltd. in its meeting on 6.2.2008 appointed another firm M/s Sharp & Co. as their new auditors for one year.* (5 Marks)
- (d) *Mr. Fat, auditor of Thin Ltd., has his office and residence in the building owned by Thin Ltd. Mr. Fat has been given 10% concession in rent by the company as compared to other tenants.* (4 Marks)

Answer

- (a) Under Section 226(3) of the Companies Act, 1956 if a person holds any security of company, having voting rights, he is disqualified from being appointed as auditor of that company.

It is further laid down in Section 226(4) that a person is not eligible for appointment as auditor of any company, if he is disqualified from acting as auditor of that company's subsidiary or holding company or any other subsidiary of the same holding company.

A firm would also be disqualified to be appointed as an auditor even if one of the partners is disqualified under this clause.

In the instant case, since Mr. Tum holds 10 shares of H.P. Ltd., which is holding company of SP Ltd., thereby he is disqualified from appointment and consequently his firm M/s Hum & Tum are not eligible to be appointed as auditor of S.P. Ltd.

By virtue of Section 224(5), the firm shall be deemed to have vacated the office after appointment, if the disqualification is applicable after such appointment.

- (b) According to Section 231 of the Companies Act, 1956 the auditors of a company are eligible and entitled to attend any general meeting of the company and not only those meetings at which the accounts audited by them are to be presented and discussed. However, it is not mandatory for the auditor to attend such meetings.

In the instant case, the board of directors of Secret Ltd., have no right to restrict Mr. Buddha from attending the general meeting and Mr. Buddha has every right to attend such meeting as conferred by Section 231.

Thus, the action of the board of directors is contrary to the provisions of law and curtails the right of the auditor.

- (c) Section 224(6)(a) of the Companies Act, 1956 lays down that the Board of Directors may fill any casual vacancy in the office of an auditor provided that where such vacancy is caused by the resignation of an auditor, the vacancy shall be filled in general meeting.

The expression "casual vacancy" has not been defined in that Act. Taking its natural meaning it may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the firm etc.

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Furthermore Section 224(6)(b) stipulates that any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM.

In the instant case the action of the board of directors in appointing M/s Sharp & Co. to fill up the casual vacancy due to dissolution of M/s Young & Co., is correct. However, the board of directors are not correct in giving them appointment for one year. M/s Sharp & Co. can hold office until the conclusion of next AGM only.

- (d) As per AAS-1 (SA 200) on Basic Principles Governing an Audit in the performance of any professional service, the auditor shall maintain independence and shall not be influenced by any other consideration. In other words, at the time of expressing an opinion he should not be influenced by any consideration and shall not acquire any direct or indirect benefit or interest from the organisation which is subject to audit.

In the instant case Mr. Fat has his office and residence in the building owned by Thin Ltd. who are subject to audit by Mr. Fat. Giving 10% concession in rent may be due to some other reasons other than holding auditor ship of Thin Ltd. It may be due to being very old tenant or due to office and residence in the same building or Mr. Fat might have carried out major renovation and so on.

Thus in the instant case unless and until there is direct proof, giving 10% concession in rent does not affect independence of the auditor in expressing his opinion on the audit of Thin Ltd.

Question 3

- (a) *In the course of audit of a trade, you noticed that although there is no change in either selling or purchase price of the goods, there is considerable increase in Gross profit ratio in comparison to previous year. What matters would you examine to assess the reason for such increase?* (10 Marks)
- (b) *What precautions should be taken by an auditor while applying test check techniques?* (6 Marks)

Answer

- (a) In assessing the reason for considerable increase in Gross Profit ratio, the auditor should examine the followings:
- (i) Under valuation of opening stock due to non-inclusion of certain items or applying lower rate to one or more items of stock.
 - (ii) Over valuation of closing stock either by the inclusion of fictitious items or over valuing some of the items of Stock.
 - (iii) Change in the method of valuation of opening and closing stock. For example, opening stock was valued at lower of cost and market value, whereas closing stock has been valued at market price which is higher than cost.
 - (iv) Goods sold but not delivered are included in stock.
 - (v) Goods delivered last year but sales invoice raised in current year.
 - (vi) Recording of fictitious sales to boost up profits.
 - (vii) Goods returned to supplier awarding dispatch and included in closing stock.

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- (viii) Goods returned by customers but not debited to Sales return and included in Closing stock.
 - (ix) Inclusion in the closing stock of goods received for sale on approval or consignment basis.
 - (x) Treatment of goods sent on consignment basis as regular sales.
 - (xi) Non-provision of outstanding expenses like wages, carriage inward etc.
 - (xii) Wrong allocation of expenses in Trading and Profit & Loss Account.
- (b)** While adopting test check technique, an auditor should take following precautions:-
- (i) The transactions of the concern should be classified under appropriate heads and may be stratified in case of wide variations between the transactions of the same kind.
 - (ii) Authorisations, documentations, recording of the transactions should be studied right from the beginning to end.
 - (iii) Evaluating the system of internal control for its efficiency, soundness and capability to produce reliable accounting and financial data.
 - (iv) Preparation of test check plan with clear audit objective understood by the audit staff.
 - (v) Un-biased selection of the transactions with reference to the random number tables or other statistical methods.
 - (vi) Identification of the areas where test check may not be done.
 - (vii) Based on degree of reliance and the confidence level required in the audit, the number of transactions to be selected for each test plan should be pre-determined.
 - (viii) Setting up criteria to judge what constitute material or immaterial errors. Further investigation of only material errors be carried out and all immaterial errors may be avoided.

Question 4

How will you vouch/verify the following?

- (a) *Sale of Investments.*
 - (b) *Payment of Revenue Expenses.*
 - (c) *Assets acquired under Hire-purchase*
 - (d) *Amount due to Subsidiary companies.*
- (4 x 4 = 16 Marks)*

Answer

(a) Sale of Investments

- (i) See that sale of investment has been made on the proper authorisation of Board or other competent authority.
- (ii) Ascertain the method of selling investments. It may be either through broker, directly or through a bank. See the broker's sold note.
- (iii) See that the difference between the carrying amount and the sales proceeds, net of

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expenses, is recognised in the Profit & Loss Account. Ensure that when only a part of the holding of an individual investment is sold, the carrying amount is allocated on the basis of average carrying amount of the total holding of the investments.

- (iv) See that proper disclosures as required by AS-13 is made as follows:-
 - (1) Interest, dividends, rentals on investments are to be shown in P& L A/c at Gross Value and TDS as advance tax paid.
 - (2) Showing separately profit & Loss on disposal and changes in carrying amount of current and long term investments.

(b) Payment of Revenue Expenses

- (i) See that all payments have been duly authorised by a competent authority.
- (ii) Ensure that all payments relates to business.
- (iii) Ensure that all payments have been received by the correct payee and acknowledged by a receipt note or in the voucher itself.
- (iv) See that expenses relate to the period under audit.
- (v) Ensure that no personal expenses are charged as business expenditure.
- (vi) See that all payments has been correctly recorded in the books under appropriate sub-head.
- (vii) See that if the payment relates to prior period it is classified so and the amount payable is correctly authorised.
- (viii) See mode of Payment cash, cheque etc., and relate to corresponding entry in cash or Bank book.
- (ix) Verify the cash memos, invoice with the amount paid.
- (x) Ensure that if any payment relates to period that extends to next year, a proportionate amount is carried forward as Pre-paid expenses.

(c) Assets acquired under Hire-purchase

- (i) Examine the hire purchase agreement to ascertain the terms and conditions, the instalments and the amount of interest included in the instalments.
- (ii) Ensure that asset is treated as finance lease under AS-19.
- (iii) Verify that initial recognition as an asset and a liability at equal amount is made. The amount to be taken should be lower of fair value of the asset or present value of the minimum lease payments (instalments).
- (iv) See that interest including penalties has been charged off to revenue.
- (v) Ensure that adequate depreciation has been provided.

(d) Amount due to subsidiary companies

- (i) Examine whether the subsidiary company is authorised by its memorandum of association to advance loan to its holding company.

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- (ii) In the absence of such a power, see whether such power could be inferred from the other objects of the company.
- (iii) verify the interest rate and particulars of security, if any, furnished.
- (iv) Inspect the documents executed by the holding company.
- (v) Verify the loan agreement and see that terms of loan have been duly complied with.
- (vi) Verify that the loan has been properly reflected in the Balance sheet as per the requirements of Schedule-VI to the Companies Act, 1956.

Question 5

- (a) *What are the assertions with which an auditor is concerned with while obtaining audit evidence from substantive procedures?* (7 Marks)
- (b) *Should branch auditor of a company comply with the request of the principal auditor of the company to give photocopy of the working papers pertaining to the branch audit? Explain.* (4 Marks)
- (c) *What is the relationship between materiality and audit risk and how audit risk can be reduced to an acceptable level?* (5 Marks)

Answer

(a) An auditor is concerned with following assertions:-

- (i) Existence: That an asset or liability exists at a given date.
 - (ii) Rights and obligations: That an asset is a right of the concern and a liability is an obligation at a given date.
 - (iii) Occurrence: That a transaction or event which took place pertains to the entity during the relevant period.
 - (iv) Completeness: That there are no unrecorded assets, liabilities or transaction.
 - (v) Valuation: That an asset or liability is recorded at an appropriate carrying value.
 - (vi) Measurement: That a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period.
 - (vii) Presentation and disclosure: That an item is disclosed classified and described in accordance with recognised accounting policies and practices and relevant statutory requirements.
- (b) As per AAS-3 (SA 230) on Documentation, Working papers are the property of the auditor. He may, at his discretion, make available portions or extracts from his working paper to his client. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers.

An auditor is not required to provide the clients or other auditors' access to his working papers. Main auditor of the company does not have right of access to the working papers of the branch auditor.

In the case of a company, the main auditor has, to consider the report of the branch

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auditor and has a right to seek clarification and to visit the branch but cannot ask for the copy of working paper and therefore, the branch auditor is under no compulsion to give photocopies of his working paper to the principal auditor.

- (c) According to AS-13 on Audit materiality, there is an inverse relationship between materiality and degree of audit risk. Higher the materiality level, lower the audit risk and vice-versa. The risk that a particular account balance or class of transaction would be mis-stated by an extremely large amount might be very low. But the risk that it could be mis-stated by an extremely small amount might be very high.

The auditor considers this inverse relationship when he determines the nature, timing and extent of his audit procedures. If after planning for specific audit procedures, he concludes that acceptable materiality level is lower, audit risk is increased. The auditor should try to reduce the audit risk to an acceptable level by:-

- (i) Reducing the assessed degree of control risk by carrying out extended or additional test of control. or
- (ii) Reducing detection risk by modifying the nature, timing and extent of his substantive procedures.

Question 6

- (a) *What are the inherent limitations of Internal Control system?* (8 Marks)
- (b) *State the matters to be specified in the Auditor's report in terms of provisions of Section 227(3) of the Companies Act, 1956.* (8 Marks)

Answer

- (a) Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as:-
- (i) Management's consideration that cost of an internal control does not exceeds the expected benefits.
 - (ii) Most controls do not tend to be directed at unusual transactions.
 - (iii) The potential of human error due to carelessness, misjudgement and misunderstanding of instructions.
 - (iv) The possibility that control may be circumvented through collusion with employees or outsiders.
 - (v) The possibility that a person responsible for exercising control may abuse that authority.
 - (vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.
 - (vii) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

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- (b) Under Section 227(3) of the Companies Act, 1956 the report of the auditor shall state the following matters:-
- (i) Whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for his audit.
 - (ii) Whether in his opinion, proper book of accounts as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from the branches not visited by him.
 - (iii) Whether the report on the accounts of any branch office audited under section 228 by a person other than the company's auditor has been forwarded to him as required to Section 228(3)(c) and how he has dealt with the same in preparing the auditor's report.
 - (iv) Whether the company's Balance sheet and Profit and Loss account dealt with by the report are in agreement with the books of accounts and returns.
 - (v) Whether in his opinion, the Balance sheet and the Profit and Loss Account comply with the accounting standards referred to in sub-section (3c) of the Section 211 of the Companies Act, 1956.
 - (vi) The observations or comments of the auditor which have any adverse effect on the functioning of the company should be in bold or Italics.
 - (vii) Whether any director is disqualified from being appointed as director under clause (g) of sub-section (1) of Section 274.
 - (viii) Whether Cess payable under section 441A has been paid and if not, the details of the amount not so paid.

Question 7

- (a) *Mention any ten special points to be examined by you in the audit of Income and Expenditure of a Charitable institution running a hospital.* (10 Marks)
- (b) *In carrying out audit of Government expenditure, what are the basic standards that you will examine and consider?* (6 Marks)

Answer

- (a) While auditing the Income and Expenditure Account of a charitable institution running a hospital, following special points may be examined:-
- (i) Verify the register of patients with duplicate copy of bills and patients admission record to see that bills have been properly and correctly prepared for all the services, tests and treatments.
 - (ii) Check cash collections from patients by tracing the receipt issued into cash book.
 - (iii) Check receipt of interest, rent, dividend etc., with receipt counterfoil into cash book and bank book and ensure that all such income has been duly accounted for.

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- (iv) Check collection of subscription, donations from the receipt issued, correspondence etc., into cash book.
 - (v) Verify that all grants from government and other bodies have been duly accounted for and have been applied in the manner as specified.
 - (vi) Verify all recurring nature of revenue expenditure, with necessary evidence like bill, authority, period etc.
 - (vii) Examine the internal check as regards the receipt and issue of stores, medicines, linen etc., to ensure that these have been properly recorded and issued/consumed only on proper authorisation.
 - (viii) See that depreciation has been written off in respect of all the assets at appropriate rate and method as in the earlier year.
 - (ix) Verify the receipts from supply of food and canteen receipts and compare the same with previous year as regards number of patients.
 - (x) Ensure that all outstanding liabilities have been adequately provided for and similarly all accrued incomes and receipts have been duly accounted for.
 - (xi) Obtain inventory of stock and stores as at the end of the year and physically check a percentage of items.
- (b) Audit of government expenditure is a major segment of government audit. The basic standards set for audit of expenditure are:-
- (i) That the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with financial rules and regulations. This is called Audit against rules and orders.
 - (ii) That there is proper sanction, either specific or general accorded by the competent authority. This is called as Audit of sanction.
 - (iii) That there is provision of funds out of which expenditure can be met with the authorisation of the competent authority. Such an audit is called Audit against provision of fund.
 - (iv) That the expenditure is incurred with due regard to broad and general principles of financial propriety. This is called as propriety audit.
 - (v) That the various programmes, schemes and projects where large financial expenditure has been incurred is being run economically and are yielding results expected of them. This is known as performance audit.

Question 8

*Write short notes on the following (any **four**):*

- (a) *Responsibilities of Joint auditors.*
- (b) *Cut-off arrangements.*
- (c) *Advantages of Statistical sampling in Auditing.*
- (d) *Inherent limitations of Audit.*
- (e) *Process of Judgement formation by Auditor.*
- (f) *Surprise checks.*

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Answer

(a) Responsibilities of Joint Auditors

As per AAS-12(SA 299), in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him. In respect of other work, which are not divided, all the joint auditors are jointly and severally responsible for:

- (i) Audit work which is not divided and is carried on jointly by all the joint auditors.
- (ii) Decision taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors.
- (iii) Matters which are brought to the notice of the joint auditors by any one of them and on which there is agreement among the joint auditors.
- (iv) Examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute.
- (v) Ensuring that the audit report complies with the requirement of the relevant statute.

(b) Cut-off arrangement

It refers to separating the transaction of one period from those in the next period so that the working results of each period can be correctly ascertained. The arrangement that is made for the purpose is technically known as cut-off arrangements. This is basically part of the internal check system.

This arrangement is generally applied to sales, purchase and stock which are usually affected by the continuity of the business. The auditor satisfies by examination and test check that the cut-off arrangement adequately ensure that:-

- (i) Goods purchased have in fact been included in the inventories and liability have been provided for credit purchases and
- (ii) Goods sold have been excluded from the inventories and credit has been taken for the sales and concerned party has been debited if the value of sale is yet to be received.

The auditor may examine a sample of documents involving the movement of stock in and out of the stores shortly before and after the cut off date and ensure that these are correctly accounted for.

(c) '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.

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(d) Inherent limitations of audit

As per AAS-2 (SA 200A), opinion expressed by the auditor is neither an assurance as to the future viability of the enterprise nor the efficiency or effectiveness with which the management has conducted affairs of the enterprise. This is because of certain inherent limitations of audit which cannot be overcome irrespective of nature and extent of audit procedures.

Auditor's work involves exercise of judgement in deciding the extent of audit procedures and deciding the reasonableness of the judgement and estimate made by the management in preparing the financial statements. The audit evidence obtained by the auditor is generally persuasive in nature rather than conclusive. Because of these factors the auditor can only express an opinion and cannot vouch with absolute certainty of financial information and results.

Failure of internal control system or its non-effectiveness also contributes to the inherent limitations of audit.

(e) Process of Judgement formation by auditor

After the audit, the opinion that the auditor expresses is the result of exercise of judgement on facts, evidence and circumstances which he comes across in the course of audit. The judgement is formed on the following basis:-

- (i) Identification of the assertions to be examined.
- (ii) Evaluation of the assertion as to relative importance.
- (iii) Collection of the information or evidence about the assertions to enable him to give an informed opinion.
- (iv) Evaluation of evidence as valid or invalid, pertinent or not pertinent, sufficient or insufficient.
- (v) Formulation of judgement as to the fairness of the assertions under consideration.

(f) Surprise Checks

Surprise checks are a part of normal audit procedures. An element of surprise can significantly improve the audit effectiveness. Wherever practical, an element of surprise should be incorporated in the audit procedures.

The element of surprise in an audit may be, both in regard to the time of audit, i.e. selection of date, when the auditor will visit the client's office for audit and selection of areas of audit.

Surprise checks are mainly intended to ascertain whether the internal control system is working effectively and whether the accounting and other records are kept up to date as per the statutory regulations. Surprise checks can exercise good moral check on the client's staff. It helps in determining whether errors or frauds exist and if they exist, brings the matter promptly to the management's attention, so that corrective action can be taken at the earliest. Surprise checks are very effective in verification of cash and investments, test checking of stock, verification of accounting records, statutory registers and internal control system. The frequency of surprise checks may be determined by the auditor in the circumstances of each audit but should normally be at least once in the course of an audit.