

PAPER – 2 : AUDITING AND ASSURANCE

Answer **all** questions.

Question 1

State with reasons (in short) whether the following statements are True or False:

- (i) While conducting audit of Government Companies, the auditors are paid their Professional Fees as prescribed by the Government.
- (ii) The auditor compares entries in the books of accounts with vouchers and if two agrees, his work is done.
- (iii) Confirmations received by the auditor directly from third parties are conclusive evidence in support of a transaction.
- (iv) Audit Committee is to be formed by each and every company and the auditor has no compulsion to attend the meeting of the Audit Committee.
- (v) A company can not declare dividends without providing for depreciation.
- (vi) When an auditor identifies a Misstatement resulting from fraud, it is his responsibility to communicate it to the regulatory and enforcement authorities apart, from those charged with governance.
- (vii) The auditor should study the Memorandum and Articles of Association to see the validity of his appointment.
- (viii) A special resolution is required by company to authorize issue of shares at discount.
- (ix) The Investments made by the company in Government Securities like NSC, Government Bonds, etc. should be kept in personal custody of Financial Controller of the Company.
- (x) The company in which 15% of subscribed capital is held by State Financial Corporation and 10% of Subscribed capital is held by General Insurance Co., the appointment of auditor can be done by passing a general resolution at annual general meeting.

(10 x 2 = 20 Marks)

Answer

- (i) **False:** As per section 224(8) of the Companies Act, 1956, the fees of auditors of Government companies is fixed by the company in general meeting or in such a manner as the company in general meeting may determine.
- (ii) **False:** The totalling of entries in the books with vouchers shows fairness of financials statements. But auditor has to determine reliability of annual statement of accounts alongwith the truth and fairness.
- (iii) **False:** Confirmations received directly from the third parties by the auditor are more reliable but same cannot be treated as conclusive evidence.
- (iv) **False:** As per section 292A of the Companies Act, 1956, Audit committee is to be formed by every public company having paid up capital of Rs. 5 crores or more. It is the duty of the auditor to attend the meeting of the audit committee.

PROFESSIONAL COMPETENCE EXAMINATION : MAY, 2010

- (v) **False** : As per section 205(1) of the Companies Act, 1956 , a company shall provide for depreciation before declaring dividend. However the Central Government may, if it thinks necessary, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous year or years without providing for depreciation.
- (vi) **True**: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" an auditor identifies a misstatement resulting from fraud or error it is his responsibility to communicate the matter with those charged with the governance and, in some circumstances, when so required by laws or regulations, to regulatory and enforcement authorities also.
- (vii) **False**: Memorandum of Association lays down the object to be carried on and Articles of Associations reflects the regulations of the company to govern its internal management and to regulate the rights of the members. Auditor should ascertain whether the company has complied with provisions of section 224, 224(A) and 225 to ensure validity of his appointment.
- (viii) **False**: As per section 79, the Companies Act, 1956, a company can issue shares at discount by passing ordinary resolution and subject to approval of the Central Government.
- (ix) **False**: There should be existence of a proper system for safe custody of all security with adequate internal control measure and documentation.
- (x) **False**: As per section 224 A of the Companies Act, 1956 when not less than 25% of subscribed share capital of a company is held by any Public Financial Institution/s or a Government Company or the Central or any State Government, a Nationalised Bank of a General Insurance Company or any combination of the above categories, the appointment of auditor shall be made only by passing a special resolution.

Question 2

Comment on the following situations:

- (a) *Mr. Y was appointed as an auditor of PQR Ltd. for the year ended 31.3.2009 at Annual General Meeting held on 16.08.2008. Mr. Y has been indebted to the company for sum of Rs. 10,000 as on 1.4.2008, the opening date of accounting year which has been subject to his audit. However, Mr. Y having come to know that he might be appointed as auditor, he repaid the amount on 10.8.2008. One of the shareholders, complains that the appointment of Mr. Y as an auditor was invalid because he incurred disqualification u/s 226 of the Companies Act, 1956.* (6 Marks)
- (b) *XYZ (Pvt.) Ltd. has paid up Capital and Reserves of Rs. 60 lacs and secured Loans of Nationalized Banks having sanctioned limit of Rs. 28 lacs and outstanding balance of Rs. 23 lacs. The turnover of the company is 5.10 crores for the year ended 31.3.2009. A customer returns goods worth 40 lacs on 2.4.2009, out of sales made during the year ended 31.3.2009. The management of CO. is of the opinion that CARO, 2003 is not applicable to the company.* (6 Marks)

PAPER – 2 : AUDITING AND ASSURANCE

- (c) C Ltd. declared dividend amounting to Rs. 5 lacs out of Profits for the year ended 31.3.2009.

Subsequently, it was noticed that company had failed to make provisions for outstanding expenses of Rs. 7.80 lacs and closing stock was also over valued, which was not reported by auditors of the company. Management of C Ltd. holds auditors responsible for this situation.

(8 Marks)

Answer

- (a) According to the sub-section 3 of section 226 of the Companies Act, 1956, a person who is indebted to the company for an amount exceeding Rs.1000/- shall be disqualified to be an auditor of such company and he should vacate office when he incurs this disqualification subsequent to his appointment. The relevant date for reckoning disqualification is the date of appointment i.e. the date of resolution passed by the company to effect such appointment. Where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for his appointment.

In the given case Mr. Y was given appointment for the year ended 31.3.09 in the AGM held on 16.8.2008, he repaid the loan amount fully to the company on 10.8.2008, before the date of his appointment and hence his appointment is valid and the shareholders complaint is invalid.

- (b) **Applicability of Company (Auditor's Report) Order 2003** :Company (Auditor's Report) Order, 2003 is applicable to a private limited company if any one of the following three conditions are fulfilled at any point of time during the period covered by the audit report -

- (i) Its paid up capital and reserves are more than Rs. 50.00 Lacs
- (ii) Its outstanding loan from bank or financial institution is more than Rs. 25.00 Lacs.
- (iii) Its turnover exceeds Rs.5 Crores.

Company (Auditor's Report) Order will be applicable even if one of the conditions is satisfied.

In the above case, the paid up capital and reserves of XYZ (Private) Ltd. is Rs.60 lacs and thus it does fulfil the first conditions. Its outstanding cash credit limit is Rs.23 lacs although sanction limit is Rs. 28 lacs. If it is assumed that sanction amount was utilized at any time during the year this clause is also fulfilled. Company's turnover is Rs. 5.10 crores. In calculation of the turnover, return of goods amounting to Rs. 40 lacs in the next financial year will not be taken into consideration and the contention of the management is not tenable.

Hence in this case the company does fulfill all the three criteria whereas fulfillment of even one criterion was sufficient for applicability of CARO, 2003.

Therefore, the contention of the XYZ (P) Ltd. is not correct and provision of CARO, 2003 will be applicable to them and the auditor has to report on the matter specified in the said order.

PROFESSIONAL COMPETENCE EXAMINATION : MAY, 2010

(c) Failure to detect untrue and incorrect financial position of a company

In the given case, profit of the company has been inflated by non-provisioning of outstanding expenses of Rs.7.80 lacs and by overvaluation of closing stock and based on such inflated profit the company has declared and paid dividend of Rs. 5.00 lacs. Thus it can be said that dividend has been paid out "inflated profit" and not out of "real profit". If there is insufficient profit after above adjustment of outstanding expenses and correction of stock valuation and there is no past reserve, it would amount to payment of dividend out of capital.

It was the duty of auditor to ascertain whether the Balance Sheet and Profit and Loss A/c of the company show a true and fair view of the financial position and revenue earning capacity. For that he has to exercise proper audit procedure of substantive test (i.e. vouching and verification) and valuation of various items of Balance Sheet and Profit and Loss a/c. The auditor should have checked whether all the outstanding expenses have been provided or not and whether closing stock has been properly valued as per AS-2. If he was not satisfied, he should have issued a qualified report or adverse report. In the instant case he has failed to do so, he will be guilty of gross negligence in the performance of his duty.

The facts of the case are similar to the established judgement on "**The Leeds Estate Building & Investment Co. Ltd vs Shepherd (1887)**", where, it was held, that it was an auditor's duty to ascertain that the accounts, he certifies, are correct and that if he fails in his duty, he is liable for damages for dividends wrongly paid by the company out of capital.

Question 3

A trader is worried that inspite of substantial increase in sales compared to earlier year, there is considerable fall in Gross Profit after satisfying himself that sales and expenses are correctly recorded and that the valuation of inventories is on consistent basis, he wants to ensure that purchases have been truthfully recorded.

How will you proceed with this assignment?

(10 Marks)

Answer

There are three steps involved in such an assignment.

- A. Study and evaluation of internal control system
- B. Vouching of purchase transactions
- C. Analytical procedures
- A. Study and evaluation of internal control system**

This involves the following steps:

- (i) **Internal check:** It should consist of the segregation of duties at the following points:
 - (a) **Requisitioning the goods:** Specified employees from the stores department or from the production department's store unit should prepare and approve a

PAPER – 2 : AUDITING AND ASSURANCE

purchase requisition for raw materials or goods used in production. The purchase requisition is sent to the purchase department.

- (b) **Ordering the goods requisitioned:** The purchase department is responsible for negotiating the best prices, fixing delivery dates with suppliers and ensuring that appropriate quality goods are obtained. It should prepare a serially numbered *purchase order*.
 - (c) **Receiving the goods ordered:** Goods ordered should be inspected and counted by the receiving department. If satisfied, it prepares serially numbered *receiving report* or *goods received note* and forwards its notification copies to the stores, purchase department and finance department.
 - (d) **Preparing the payment voucher:** The accounts payable department or accounts payable unit of finance department will receive the invoices and process for its payment and accounting.
- (ii) **Physical controls**
- (a) Physical controls over inventory include locked warehouses and store-rooms and limiting access to them to authorised personnel and
 - (b) Printed and prenumbered forms should be used for purchase requisitions, purchase orders, receiving reports and vouchers.
- (iii) **Authorised procedures**
- (a) Re-order points should be established for various inventory items that may trigger a manual request.
 - (b) Authorisation procedures should be designed for all the four control points – requesting the goods, ordering the goods requisitioned, receiving the goods ordered and preparing the payment voucher.
- (iv) **Internal review**
- (a) It should ensure that there is adequate separation of duties and proper authorisation procedures with regard to processing and recording of purchase transactions.
 - (b) Paid invoices should be reviewed to ascertain the accuracy of the recording of these invoices and if possible, these invoices should be traced back to purchase requisition through receiving reports or goods received notes and purchase orders.

B. Vouching of purchases transactions

The auditor should vouch credit purchases in the following manner:

- (i) *Examine purchase book:* The auditor should examine the transactions recorded in the purchase book with reference to related purchase invoice.
- (ii) *Examine purchase invoices:* The auditor should select a small sample of vendors' invoices at random and should conduct in-depth audit on them i.e., trace the

PROFESSIONAL COMPETENCE EXAMINATION : MAY, 2010

transaction from placing the order to the entries in inventory goods for actual receipt and payment made to the suppliers. In respect of imports, documents such as bill of lading, customs clearance, etc. should be examined. The auditor should ensure that subsidies, rebates, duty drawbacks or other similar items have been properly accounted for.

- (iii) *Examine the numerical sequence of source documents:* The auditor should ensure the numerical sequence of source documents such as purchase requisitions, purchase orders, receiving reports and vouchers have been maintained and missing numbers have been duly accounted for.
- (iv) *Examine cut off points:* In order to ensure that purchases were recorded at that point of time when title was passed to the client, the auditor should examine cut-off points on prenumbered purchase requisitions, purchase orders and goods received notes. The auditor should, then, trace the goods received notes pertaining to a few days before the end of the period under audit to the related purchase invoices. Such a comparison would ensure that purchases represented by such invoices have been recorded as the purchases of the period under audit.
- (v) Examine transition with related parties carefully.

C. Analytical procedures

The auditor should compare item-wise and location-wise both quantity and value of purchases for the current period with the corresponding figures for the previous period and ensure that major variations are explained and justified. Various analytical ratios should also be calculated and compare.

Question 4

- (a) *Discuss Internal Controls in a CIS Environment.* (5 Marks)
- (b) *Differentiate between 'Qualified report' and 'Adverse report'.* (5 Marks)

Answer

(a) Internal controls in CIS Environment:

The internal controls over computer processing, which help to achieve the overall objectives of internal control, include both manual procedures and procedures designed into computer programmes. Such manual and computer controls affect the CIS environment (general CIS controls) and the specific controls over the accounting applications (CIS application controls).

General CIS Controls: The purpose of general CIS controls is to establish a framework of overall control over the CIS activities and to provide a reasonable level of assurance that the overall objectives of internal control are achieved. These controls may include:

- (1) *Organisation and management controls are designed to establish an organizational framework over CIS activities, including:*
 - (i) Policies and procedures relating to control functions.

PAPER – 2 : AUDITING AND ASSURANCE

- (ii) Appropriate segregation of incompatible functions.
- (2) *Application systems development and maintenance controls are designed to establish control over:*
 - (i) Testing, conversion, implementation and documentation of new or revised systems.
 - (ii) Changes to application systems.
 - (iii) Access to systems documentation
 - (iv) Acquisition of application systems from third parties.
- (3) *Computer operation controls are designed to control the operation of the systems and to provide reasonable assurance that:*
 - (i) The systems are used for authorised purposes only.
 - (ii) Access to computer operations is restricted to authorised personnel.
 - (iii) Only authorised programs are used.
 - (iv) Processing errors are detected and corrected.
- (4) *Systems software controls include:*
 - (i) Authorisation, approval, testing, implementation and documentation of new systems software and systems software modifications.
 - (ii) Restriction of access to systems software and documentation to authorised personnel.
- (5) *Data entry and program controls are designed to provide reasonable assurance that:*
 - (i) An authorisation structure is established over transactions being entered into the system.
 - (ii) Access to data and programs is restricted to authorised personnel.
 - (iii) Offsite back-up of data and computer programmes.
 - (iv) Recovery procedures for use in the event of theft, loss or intentional or accidental destruction.
 - (v) Provision for offsite processing in the event of disaster;

CIS Application Controls: The purpose of CIS application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorised and recorded, and are processed completely, accurately and on a timely basis. These include:

- (1) *Controls over input are designed to provide reasonable assurance that:*
 - (i) Transactions are properly authorised before being processed by the computer.

PROFESSIONAL COMPETENCE EXAMINATION : MAY, 2010

- (ii) Transactions are accurately converted into machine readable form and recorded in the computer data files.
 - (iii) Transactions are not lost, added, duplicated or improperly changed.
 - (iv) Incorrect transactions are rejected, corrected and if necessary, resubmitted on a timely basis.
- (2) *Controls over processing and computer data files are designed to provide reasonable assurance that:*
- (i) Transactions, including system generated transactions, are properly processed by the computer.
 - (ii) Transactions are not lost, added, duplicated or improperly changed.
 - (iii) Processing errors are identified and corrected on a timely basis.
- (3) *Controls over output are designed to provide reasonable assurance that:*
- (i) Results of processing are accurate.
 - (ii) Access to output is restricted to authorised personnel.
 - (iii) Output is provided to appropriate authorised personnel on a timely basis

(b) Distinction between Qualified report and Adverse report

1. A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate, to disclose the misleading or incomplete nature of the financial statements.
2. In qualified report, the auditor's reservation is generally written as "subject to or except for, we report that the Balance Sheet shows a true and fair view". Whereas in case of adverse report, the auditor states that "the financial statements do not present a true and fair view of the state of affairs and working results".
3. In the qualified report, the auditor gives an opinion subject to certain reservations whereas in the case of adverse report the auditor concludes that on the basis of his examination he is not satisfied with the affirmation made in the financial statements.

Question 5

- (a) *Draft an audit programme for conducting audit of accounts of a Local Body. (5 Marks)*
- (b) *'The extent of audit procedure performed on corresponding figure is less compared to audit of current period figures', reporting. Justify the statement with regard to auditor's duties for reporting of comparatives under SA 710. (5 Marks)*

PAPER – 2 : AUDITING AND ASSURANCE

Answer

(a) Audit of local bodies

- (i) The Local Fund Audit Wing of the State Government is generally in charge of the audit of municipal accounts. Sometimes bigger municipal corporations e.g. Delhi, Mumbai etc have power to appoint their own auditors for regular external audit. So the auditor should ensure authenticity of his appointment.
- (ii) The auditor while auditing the local bodies should report on the fairness of the contents and presentation of financial statements, the strengths and weaknesses of system of financial control, the adherence to legal and/or administrative requirements; upon whether value is being fully received on money spent. His objective should be, to detect errors and fraud and misuse of resources.
- (iii) The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law and is in accordance with the financial rules and regulations framed by the competent authority.
- (iv) He should ensure that all types of sanctions, either special or general, accorded by the competent authority.
- (v) He should ensure that there is a provision of funds and the expenditure is incurred from the provision and the same has been authorized by the competent authority.
- (vi) The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results.

(b) Comparatives

As per SA 710 "Comparatives" the following are the broad principles"

- (i) The auditor should determine whether the comparatives comply, in all material respects, with the financial reporting framework relevant to the financial statements being audited.
- (ii) The auditor should obtain sufficient appropriate audit evidence that the corresponding figures meet the requirements of the relevant financial reporting framework.
- (iii) When the comparatives are presented as corresponding figures, the auditor's report should not specifically identify comparatives because the auditor's opinion is on the current period financial statements as a whole, including the corresponding figures.
- (iv) When the auditor's report on the prior period, as previously issued, included a qualified opinion, disclaimer of opinion, or adverse opinion and the matter which gave rise to the modification in the audit report is
 - (a) unresolved and results in a modification of the auditor's report regarding the current period figures, the auditor's report should also be modified regarding the corresponding figures or

PROFESSIONAL COMPETENCE EXAMINATION : MAY, 2010

- (b) unresolved, but does not result in a modification of the auditor's report regarding the current period figures, the auditor's report should be modified regarding the corresponding figures.
- (v) In case of material misstatement of prior period detected subsequently, the auditor should examine that appropriate disclosures have been made, if appropriate disclosures have not been made, the auditor should issue a modified report on the current report financials modified with respect to the corresponding figures included therein.
- (vi) When the prior period financial statements are not audited, in the incoming auditor should state in the auditor's report that the corresponding figures are unaudited.

Question 6

- (a) *'Doing the audit in EDP environment is simpler since Trial Balance always tallies.' Analyse the statement critically.* (5 Marks)
- (b) *'A Joint Auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report.'*
Justify this statement in the light of responsibilities of Joint Auditors under SA 299. (5 Marks)

Answer

(a) Audit in EDP environment

Though it is true that in EDP environment the trial balance always tallies, the same can not imply that the job of an auditor becomes simpler. There can still be some accounting errors like omission of certain entries, compensating errors, duplication of entries, errors of commission in the form of wrong head of accounts etc. Possibility of "Window Dressing" and/or "Creation of Secret Reserves" can be possible in EDP environment also in spite of tallied trial balance. At present, due to complex business environment the importance of trial balance cannot be judged only upto the arithmetical accuracy but the nature of transactions recorded and its classification in the books should be focused.

The emergence of new forms of financial instruments like options and futures, derivatives, off balance sheet financing etc have given rise to further complexities in recording and disclosure of transactions. In an audit, besides the tallying of a trial balance, there are other issue also like estimation of provision for depreciation, estimation of tax liability, valuation of inventories, obtaining audit evidence, ensuring compliance with various laws, regulations and standards, verification of existence and valuation of assets and liabilities, reporting requirement as per statute etc. which still requires judgement to be exercised by the auditor.

The EDP processing and recording has its own complexities and requires lot of controls, safeguards and application which requires specialised knowledge and skill for proper implementation.

PAPER – 2 : AUDITING AND ASSURANCE

Responsibility of expressing an audit opinion and objectives of an audit are not changed in the audit in EDP environment. Compliance with various laws and standards are still to be verified, ensured and reported.

Therefore, it can be said that simply because of EDP environment and tallying of the trial balance, the audit can't be said to have become simpler.

- (b) **Responsibility of Joint Auditors:** SA 299 on, "Responsibility of Joint Auditors" prescribes the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. The responsibilities of joint auditors, as a rule are no different from the responsibilities of individual auditors as enumerated in the Companies Act, 1956. Main features of the said SA are discussed below:

- ◆ **Division of Work:** Where joint auditors are appointed, they should, by mutual discussion, divide the audit of identifiable units or specified areas. Certain areas of work, owing to their importance or owing to the nature of work involved would not be divided and would be covered by all the joint auditors. Such a division affected by the joint auditors should be adequately documented and preferably communicated to the auditee.
- ◆ **Coordination:** Where in the course of his work, a joint auditor comes across matters which are relevant to the areas of other joint auditors and which require joint discussion, he should communicate the same to all the other joint auditors in writing before the finalisation of audit and preparation of audit report.

In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

- (i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (ii) in respect of decisions 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) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
- (v) for ensuring that the audit report complies with the requirements of the relevant statute.
- (vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit.
- (vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors.

PROFESSIONAL COMPETENCE EXAMINATION : MAY, 2010

- (viii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are able to arrive at an agreed report. However where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

Question 7

How would you vouch/verify the following?

(a) *Reduction in Share Capital*

(b) *Receipt of Capital subsidy.* (5 x 2 = 10 Marks)

Answer

(a) Reduction in Share Capital

- (i) Verify that the meeting of the shareholders was properly convened and the proposal of reduction of share capital was passed by Special Resolution and also that the proposal was circularised in advance among the members
- (ii) Verify that the reduction of share capital is authorised by the Articles of Association and the procedure prescribed by the Articles has been followed.
- (iii) Examine the order of the Tribunal confirming the reduction of share capital and see that a copy of the order and the minutes have been registered and filed with the Registrar of Companies.
- (iv) Inspect Registrar's Certificate as regards reduction of capital.
- (v) Vouch the journal entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also seeing that the requirements of Schedule VI, Part I, have been complied with.
- (vi) Confirm that revaluation of assets have been properly disclosed in Balance Sheet.
- (vii) Verify the adjustment made in the member's accounts in the Register of Members and confirm that either the paid up amount shown on the old share certificates have been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled.
- (viii) Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
- (ix) Verify that the Memorandum of Association of the company has been suitably altered.

PAPER – 2 : AUDITING AND ASSURANCE

(b) Receipt of Capital Subsidy

- (i) Refer to office copy of application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- (ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to use of subsidy.
- (iii) See that conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up an industrial unit at a specified area/location.
- (iv) Check the relevant entries in the books for receipt of subsidy.
- (v) Ensure that compliance requirements of AS 12 on “Accounting for Government Grants” i.e. whether it relates to specific amount or in the form of promoters’ contribution and accordingly accounted for and also compliance with the disclosure requirements.

Question 8

Write short notes on the following:

(a) *Substantive Procedures*

(b) *Audit Working Papers.*

(5 x 2 = 10 Marks)

Answer

(a) Substantive Procedures

These procedures are audit tests designed to obtain evidence to verify balance of an account or a specific financial statement assertion i.e. they test the validity and propriety of the accounting treatment of the transaction. They can be classified as either test of details of transactions and balances or as analytical review procedures. They provide assurance to the auditor in respect of the following assertions

- (i) The asset or a liability should exist at a given date.
- (ii) The asset should be owned by the entity and the liability is an obligation of the entity at a given date.
- (iii) There should not be any unrecorded assets, liabilities or transactions.
- (iv) Assets or liabilities should be recorded at appropriate carrying values.
- (v) Transaction or event that took place should pertain to the entity during the relevant period.
- (vi) Transaction should be recorded in the proper amount and revenue or expense should be allocated to the proper period.
- (vii) Various items should be disclosed, classified, and described in accordance with recognised accounting policies and practices and relevant statutory requirements, if any.

PROFESSIONAL COMPETENCE EXAMINATION : MAY, 2010

(b) Audit Working Papers:

The audit working papers constitute the link between the auditor's report and the client's records. SA 230 (revised) on "Audit Documentation" states that Audit Working papers *are* the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. The object of Audit working papers is to provide:

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

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

- (a) Assisting the engagement team to plan and perform the audit.
- (b) Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with Proposed SA 220 (Revised).
- (c) Enabling the engagement team to be accountable for its work.
- (d) Retaining a record of matters of continuing significance to future audits.
- (e) Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- (f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Working papers should contain audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained. The auditor shall assemble the audit working papers in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. The retention period for audit working papers ordinarily is no shorter than ten years from the date of the auditor's report, or, if later, the date of the group auditor's report. Unless otherwise specified by law or regulation, audit working papers are the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients.