

PAPER – 6 : AUDITING AND ASSURANCE

Question No.1 is compulsory.

*Attempt any **five** questions from the remaining six questions.*

Question 1

Comment on the following in relation to SAs:

- (a) *"The work performed by each assistant needs to be reviewed by personnel of at least equal competence."* (5 Marks)
- (b) *"Audit documentation serves a number of additional purposes."* (5 Marks)
- (c) *"Management is responsible for compliance with laws and regulations."* (5 Marks)
- (d) *"Auditor shall establish an overall strategy that sets the scope, timing and directions of the audit, and that guides the development of the audit plan."* (5 Marks)

Answer

- (a) **Reviewing the work performed by Assistant :** As per SA 220 "Quality Control for an Audit of Financial Statements" the firm's review responsibility policies and procedures are determined on the basis that work of less experienced team members is reviewed by more experienced team members. However, it has placed the final responsibility of review of audit engagement on engagement partner.

Engagement partner is the partner or other person in the firm who is a member of the Institute of Chartered Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Reviews at appropriate stages, during the audit engagement allow significant matters to be resolved on a timely basis, to the engagement partner's satisfaction on or before the date of the auditor's report:

The engagement partner shall ensure that reviews being performed are in accordance with the firm's review policies and procedures. A review consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;

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- The work performed supports the conclusions reached and is appropriately documented;
 - The evidence obtained is sufficient and appropriate to support the auditor's report; and
 - The objectives of the engagement procedures have been achieved.
- (b) Audit Documentation :** According to SA 230 on "Audit Documentation", audit documents once collected serves a number of additional purposes. These purposes are as follows:-
- (i) Assisting the engagement team to plan and perform the audit.
 - (ii) 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 SA 220 "Quality Control for an Audit of Financial Statements".
 - (iii) Enabling the engagement team to be accountable for its work.
 - (iv) Retaining a record of matters of continuing significance to future audits.
 - (v) Enabling the conduct of quality control reviews and inspections.
 - (vi) Enabling the conduct of external inspections in accordance with applicable legal regulatory or other requirements.
- (c) Management's responsibility for compliance with laws and regulations :** According to SA 250 on "Consideration of Laws and Regulations in an Audit of Financial Statements", it is management's responsibility, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations. Laws and regulations may affect an entity's financial statements in different ways for example, most directly; they may affect specific disclosures required of the entity in the financial statements. The following are the procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations:-
- (i) Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
 - (ii) Instituting and operating appropriate systems of internal control.
 - (iii) Developing, publicising and following a code of conduct.
 - (iv) Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
 - (v) Engaging legal advisors to assist in monitoring legal requirements.
 - (vi) Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.
 - (vii) Ensuring employees are properly trained and understand the code of conduct.
- (d) Establishment of overall strategy for development of audit plan :** According to SA 300, "Planning an Audit of Financial Statements" the auditor shall establish an overall

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audit strategy that sets the scope, timing and directions of the audit, and that guides the development of the audit plan.

In establishing the overall audit strategy, the auditor shall:

- (i) Identify the characteristics of the engagement that define its scope;
- (ii) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- (iii) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- (iv) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- (v) Ascertain the nature, timing and extent of resources necessary to perform the engagement.

Question 2

- (a) *Explain various methods to obtain audit evidence.* (8 Marks)
- (b) *List out some examples of fraud that can be done by ledger keeper in Bought ledger and sales ledger.* (8 Marks)

Answer

- (a) **Methods to obtain Audit Evidence:** The auditor obtains evidence in performing compliance and substantive procedures by one or more of the following methods:-

- (i) **Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the

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valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

- (ii) **Observation:** Observation consists of looking at a process **or** procedure being performed by the others. For example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.
- (iii) **External Confirmation:** An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a "side agreement" that may influence revenue recognition.
- (iv) **Recalculation:** Recalculation consists of checking the arithmetical accuracy of documents or records. Recalculation may be performed manually or electronically.
- (v) **Reperformance:** It involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.
- (vi) **Analytical Procedure:** Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.
- (vii) **Inquiry:** Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

(b) Ledger Keeper & Frauds

Examples of frauds that can be done by ledger keeper in bought ledger:

- (i) Crediting the account of a supplier on the basis of a fictitious invoice, showing that certain supplies have been received from the firm, whereas in fact no goods have

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been received or on the basis of duplicate invoice from a supplier, the original amount whereof has already been adjusted to the credit of the supplier in the Bought Ledger, and subsequently misappropriating the payment made against the credit in the supplier's accounts.

- (ii) Suppressing a credit note issued by a supplier in respect of return or an allowance and misappropriating an amount equivalent thereto out of the payment made to him. For if a credit note issued by a supplier either in respect of goods returned to him or for an allowance granted by him, is not debited to his account, the balance in his account in the Bought Ledger would be larger than the amount actually due to him. The ledger-keeper thus will be able to misappropriate the excess amount standing to the supplier's credit.
- (iii) Crediting an amount due to a supplier not in his account but under a fictitious name and misappropriating the amount paid against the credit balance.

Examples of frauds that can be done in sales ledger:

- (i) Teeming and Lading: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. Similarly, moneys received from the customer who has paid thereafter being credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time, which may lead the management to either send out a statement of account to him or communicate with him.
- (ii) Adjusting an unauthorised credit or fictitious rebate, allowance, discount, etc. in the account with a view to reduce the balance and when payment is received from the debtor, misappropriating an amount equivalent to the credit.
- (iii) Writing off the amount receivable from a customer's bad debt account and misappropriating the amount received in payment of the debt.

Question 3

- (a) *Discuss Limitation of audit.* (8 Marks)
- (b) *Discuss perquisites and fundamental principles to be possessed by an auditor.* (8 Marks)

Answer

- (a) **Limitations of Audit** : As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the objectives of an audit of financial statements, prepared with in a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements. In forming his opinion on the financial statements, the auditor follows procedures designed to satisfy him that the financial statements reflect a true and fair view of the financial position and operating

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results of the enterprise. The process of auditing, however, is such that it suffers from certain limitations, i.e. the limitation which cannot be overcome irrespective of the nature and extent of audit procedures. The limitations of an audit arise from:

- i. **The Nature of Financial Reporting:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures.
- ii. **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:
 1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
 2. Fraud may involve sophisticated and carefully organised schemes designed to conceal it. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
 3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
- iii. **Timeliness of Financial Reporting and the Balance between Benefit and Cost:** The relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.
- iv. **Other Matters that Affect the Limitations of an Audit:** In the case of certain assertions or subject matters, the potential effects of the limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:
 - Fraud, particularly fraud involving senior management or collusion.
 - The existence and completeness of related party relationships and transactions.
 - The occurrence of non-compliance with laws and regulations.

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- Future events or conditions that may cause an entity to cease to continue as a going concern.

Because of the limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

(b) Prerequisites or fundamental principles in Auditor: It is in the best interest of the accountancy profession to make known to users, of the services provided by an auditor that they are executed at the highest level of performance and are in accordance with ethical requirements that strive to ensure such performance. In order to achieve the objectives of accountancy profession, the auditor have to observe a number of prerequisites' or fundamental principles as under:

- (i) **Integrity:** An auditor should be straight forward and honest.
- (ii) **Objectivity:** An auditor should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity.
- (iii) **Professional competence and due care:** An auditor should perform his duty with due care, competence and diligence and has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service based on up-to-date developments in practice, legislation and techniques-
- (iv) **Confidentiality:** An auditor should respect the confidentiality of information acquired during the course of an audit and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.
- (v) **Professional behavior:** An auditor should act in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession.
- (vi) **Technical Standard:** An auditor should carry out professional services in accordance with the relevant technical and professional standards.

Question 4

- (a) Give various factors which result in increase in Gross profit. (8 Marks)
- (b) Define depreciation and discuss various purposes of providing depreciation. (8 Marks)

Answer

(a) Factors which increase the gross profit:

- (i) Undervaluation of opening stock; it may be either the effect of non-inclusion of certain items of stocks or that of valuation of the stock at a rate lower than that warranted by the basis of valuation adopted or miscalculation of the value of one or

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more items of stock. In such a case, the increase in the rate of gross profit would be preceded by a fall in the rate of gross profit in the previous year.

- (ii) Overvaluation of closing stock, either by the inclusion therein of fictitious items of stock or over-statement of values of some of them.
- (iii) Alteration of the basis of valuation of closing stock, e.g., where the opening stock was valued at cost or market rate whichever was lower, valuing the closing stock at the market price which is higher than cost.
- (iv) Increase in the value of some of the items included in the opening stock above cost, on account of which the unsold stock of these items at the close of the year is valued at cost.
- (v) Under-statement of opening stock or over-statement of closing stock, due to adjustment of the amount of sales, when goods sold but not delivered are included in the closing stock or when goods were delivered and taken out of stock last year, but sales invoices is raised in the current year.
- (vi) Entry of fictitious purchases to boost up the profits, if such a practice has been resorted to, it would have the effect of reducing the rate of gross profit in the ensuing year.
- (vii) Inclusion in the closing stock of goods returned awaiting despatch to supplier, the cost of which has been debited to them or goods returned by customers, the cost whereof has not been credited to parties.
- (viii) Inclusion in the closing stock of goods received for the sale on approval or on a consignment basis.
- (ix) Treatment of goods sent out for sale on consignment basis as regular sales.
- (x) No provision or under-provision in the expenses accounts included in the Trading Account. For example, purchase may be understated; provision for outstanding wages or carriage inward may not have been made.
- (xi) Wrong allocations of expenses, e.g., carriage inwards either in whole or in part may be wrongly taken to the Profit and Loss Account.

(b) Depreciation:

Definition : According to AS-6 "Depreciation Accounting" issued by the Institute of Chartered Accountants of India "Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time, obsolescence through technology and market charges. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose usefulness is predetermined".

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The term “depreciable amount” of a depreciable asset as per the standard is its historical cost, or other amount substituted for historical cost in the financial statements less the estimated residual value.

The accounting standard recommends that the depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.

Purpose of Providing Depreciation:

- (i) **To keep capital intact:** It will be evident that one of the effects of providing for depreciation on an asset is to retain an amount (equal to the proportion of the cost of the asset employed in the business that has run off, estimated on the basis of the period of its working life and its scrap value) in the business out of the profits in each year.
- (ii) **To ascertain cost accurately:** Unless a proper charge on account of depreciation is included in the Profit and Loss Account, the true cost of manufacture of different products will not be ascertained. This is because depreciation is as much a charge against revenue as any other expenditure and must be included in accounts irrespective of the fact whether the final result of a working is profit or loss.
- (iii) **To charge initial costs against earnings :** The cost of a machine less its scrap value can, in effect, be regarded as the price for use of the machine paid in advance for the period it will be rendering service. According to this view unless an appropriate part of this price is charged to the profits of the business each year, the profit earned on its working will not be correctly ascertained.
- (iv) **To prepare true and fair statements:** Unless depreciation is provided, the assets will be shown at an amount higher than their true value and the profit shown will be more than the real profit. In other words, the Balance Sheet and the Profit and Loss Account will not be true and fair.

Question 5

Mention any 8 special points which you as an auditor would look into while auditing the books of accounts of:

- (a) *Hospital.* (8 Marks)
- (b) *Cinema.* (8 Marks)

Answer

(a) Audit of Hospital:

The special steps involved in such an audit are as follows:

- (i) Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been

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correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.

- (ii) Check cash collections as entered in the Cash Book with the receipt, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
- (iii) See by reference to the Property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities settled on the hospital has been collected.
- (iv) Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (v) Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile that total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (vi) Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
- (vii) Verify that grants, if any, received from Government or local authority have been duly accounted for. Also that refund in respect of taxes deducted at source has been claimed.
- (viii) Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee significant variations which have taken place.
- (ix) Examine the internal check as regards the receipts and issue of stores; medicines, lines, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Stock Register and that issues have been made only against proper authorisation.
- (x) See that depreciation has been written off against all the assets at the appropriate rates.
- (xi) Inspect the bonds, share scripts, title deeds of properties and compare their particulars with those entered in the Property and Investment Register.
- (xii) Obtain inventories, specially of stocks and stores as at the end of the year and check a percentage of the items physically, also compare their total values with respective ledger balances.

(b) Audit of Cinema:

The special steps involved in its audit are as follows:-

- (i) Verify

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- (1) that entrance to the cinema hall during show is only through printed tickets;
 - (2) that they are serially numbered and bound into books;
 - (3) that the number of tickets issued for each show and class, are different with the numbers of the same class for the show on the same day, each week, sum serially;
 - (4) that for advance booking a separate series of tickets is issued; and
 - (5) that the stock of tickets is kept in the custody of a responsible official.
- (ii) Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
 - (iii) Verify that a record is kept of the 'free passes' and that these are issued under proper authority.
 - (iv) Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class.
 - (v) Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different show on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.
 - (vi) Verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts Exhibited kept at the cinema as well with the agreements, entered into with advertisers in this regard.
 - (vii) Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalised except the expenditure on extensive redecoration, and that should be adjusted as deferred revenue expenditure.
 - (viii) Confirm that depreciation on machinery and furniture has been charged at an appropriate rate which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.
 - (ix) Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.
 - (x) Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If any film in respect of which an advance was paid has already run, it should be enquire as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.
 - (xi) The arrangement for collection of the share in the restaurant income should be enquired into either a fixed sum or a fixed percentage of the taking may be receivable annually. In case the restaurant is run by the Cinema, its accounts should be checked. The audit should cover sale of various items of foodstuffs, purchase of foodstuffs, cold drink, cigarettes, etc. as in the case of club.

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Question 6

- (a) *Explain the concept of joint audit. Discuss its advantage and disadvantage.* (8 Marks)
(b) *Explain the powers of company to purchase its own securities.* (8 Marks)

Answer

(a) Joint Audit:

The practices of appointing chartered accountants as joint auditors is quite widespread in big companies and corporations, joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work.

When more than one auditor is appointed to audit large entities, such auditors are called joint auditors. Joint auditors have a collective responsibility to report on the financial statements. SA 299, "Joint Audit" deals with duties, rights and professional responsibilities of joint auditors. The joint auditors should follow the principles of division of work and coordination while conducting joint audits.

Advantages of Joint Audit:-

- (i) Pooling and sharing of expertise
- (ii) Advantage of mutual consultation.
- (iii) Lower work load
- (iv) Better quality of work performance.
- (v) Improved service to the client.
- (vi) Displacement of the auditor of the company in a take-over often obviated.
- (vii) In respect of multinational companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
- (viii) Lower staff development costs.
- (ix) Lower costs to carry out the work.
- (x) A sense of healthy competition towards a better performance.

Disadvantages of Joint Audit:-

- (i) The fees being shared.
- (ii) Psychological problem where firms of different standing are associated in the joint audit.
- (iii) General superiority complexes of some auditors.

- (iv) Problems of coordination of the work.
- (v) Areas of work of common concern being neglected.
- (vi) Uncertainty about the liability for the work done.
- (vii) Lack of clear definition of responsibility.

(b) Power of Company to purchase its own securities:

- (i) The Companies (Amendment) Act, 1999 contains elaborate provisions enabling a company to buy-back its own securities. The word securities includes employees stock option and both equity and preference shares. As per section 77A, a company may purchase its own shares or other specified securities (hereinafter referred to as "buy-back") out of:-
 - (1) its free reserves; or
 - (2) the securities premium account; or
 - (3) the proceeds of any earlier issue other than from issue of shares made specifically for buy back purposes.
- (ii) No company shall purchase its own shares or other specified securities unless:-
 - (1) the buy back is authorized by its articles.
 - (2) a special resolution has been passed in general meeting of the company authorizing the buy-back. Provided that nothing contained in this clause shall apply in any case where (i) the buy back is or less than 10% of the total paid up equity capital and free reserve of the company and (ii) such buy back has been authorized by the Board by means of a resolution passed at its meeting.
 - (3) the buy back is or less than 25% of the total paid-up capital (equity shares and preference shares) and free reserves of the company:-
 - (4) the debt equity ratio is not more than 2:1 after such buy back.
Explanation.—For the purposes of this clause, the expression "debt" includes all amounts of unsecured and secured debts;
 - (5) all the shares or other specified securities are fully paid up.
 - (6) the buy back of the shares or other specified securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India;
 - (7) the buy back in respect of shares or other specified securities other than those specified in clause(f) is in accordance with the guidelines as may be prescribed.
- (iii) The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating:-

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- (1) a full and complete disclosure of all material facts;
 - (2) the necessity for the buy back.
 - (3) the class of securities intended to be purchased;
 - (4) the amount to be invested; and
 - (5) the time limit for completion of buy back
- (iv) Every buy back shall be completed within 12 months from the date of passing the special resolution.
- (v) the buy back under sub section(1) may be
- (1) from the existing security holders on a proportionate basis; or
 - (2) from the open market; or
 - (3) from odd lots;
 - (4) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.
- (vi) A solvency certificate to be filed before making buy back
- (vii) A company buy -back its own securities, it shall extinguish and physically destroy the securities so bought-back within 7 days of the last date of completion of buy back.
- (viii) A company shall not make further issue of same kind of shares or other specified securities within a period of 6 months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.
- (ix) A company maintains a register of the securities so bought, the consideration paid for the securities bought back, the date of cancellation of securities, the date of existing and physically destroying of securities and such other particulars as may be prescribed.
- (x) A company shall, after completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy back within 30 days of such completion as may be prescribed.

Provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognized stock exchange.

Question 7

Write short notes on any four of the following:-

- (a) *Reissue of redeemed debentures.*

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- (b) *Internal control in small business*
- (c) *Stratified sampling*
- (d) *Audit of expenditure in Government audit.*
- (e) *Cut-off procedure.*

(4 × 4 = 16 Marks)

Answer

(a) Re-issue of redeemed debentures: A company may issue debentures previously redeemed, either by reissuing the debentures or by issuing others in their place unless the articles or a contract or resolution, recorded at a General Meeting, or terms of issue or some other act of the company expressly or impliedly manifest the intention that, on redemption, the debentures shall be cancelled. However, the re-issue of redeemed debentures or the issue of others in their place are treated as a new issue for the purpose of stamp duty and the rights and privileges attaching to the debentures that re-issued shall be the same as if the debentures had never been redeemed. On these considerations, it is necessary for the auditor to verify the re-issue of debentures in the same manner as those issued for the first time.

(b) Internal control in small business: The auditor needs to obtain the same degree of assurance in order to give an unqualified opinion on the financial statements of both small and large entities. However, many controls which would be relevant to large entities are not practical in the small business e.g. in small business accounting work may be performed by only a few persons. These persons may have both operating and custodial responsibilities, and segregation of functions may be missing or severally limited.

Inadequate segregation of duties may, in some cases, be off set by owner/manager supervisory controls which may exist because of direct personal knowledge of the business and involvement in the business transactions. In circumstances where segregation of duties is limited or evidence of supervisory controls is lacking, the evidence necessary to support the auditors' opinion on the financial information may have to be obtained largely through the performance of substantive procedure.

(c) Stratified Sampling: This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgement.

The reason behind the stratified sampling is that for a highly diversified population, weights should be allocated to reflect these differences. This is achieved by selecting different proportions from each strata. It can be seen that the stratified sampling is simply an extension of simple random sampling.

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(d) Audit of Expenditure in Government Audit: The various standards set for audit of expenditure are:

- (i) **Audit against Rules & Orders:** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
- (ii) **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
- (iii) **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
- (iv) **Propriety Audit:** It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.
- (v) **Performance Audit:** This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them.

(e) Cut off procedure: Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained. The procedure that is made for this purpose is technically known as "cut-off procedure".

It means procedure employed to ensure the separation of transaction at the end of one year from those in the commencement of the next year. Principle areas of application of cut-off procedures involve sales, purchase and stock.

The auditor generally examines the last cut-off document at the end of each year. There after the auditor examines a sample of documents evidencing the movement of stock into and out of stores, including documents pertaining to period shortly before and shortly after the cut off date and check whether the stocks and sales are appropriately reflected in the right accounting period.

It is the duty of the auditor to satisfy himself that:-

- (i) Goods purchased for which property has passed to the client has been included in the inventory and that liability has been provided for in case of credit purchase.
- (ii) Goods sold have been excluded from inventories and credit has been taken for sales. If the value of sales is to be received, the concerned party has been debited.