Qn (1) (a) This statement is not correct. Standards are basically classified into following categories :

(1) Standards on Quality control (SQC) (1-99)

(2) Standards on Auditing (100-899)

(3) Standards on Review Engagements (SRE) (2000-2699)

(4) Standards on Assurance Engagement (SAE) (3000-3699)

(5) Standards on Related Services (SRS) (4000-4699)

Therefore Engagement Standards are only a part of Standards and all Standards are not collectively known as the Engagement Standards.

Qn (1)(b) Where shares have been issued for purpose of raising money to defray (to meet) the expenses of construction of any work or building or provision of any plant, which can not be made profitable for a lengthy period, interest on such share capital can be paid if following conditions are satisfied :-

(1) **Authorisation :**No such payment shall be made unless authorised by AOA or SR.

(2) **Sanction :**Prior sanction of C.G. is also required. C.G may make enquiry through any person on the circumstances of case before giving sanction.

(3) **Rate of interest :**The rate of interest shall not exceed 12% p.a. or such rate as C.G. declares by notification in the official gazette.

(4) **Time Period :** The payment of interest shall be made only for such period as determined by C.G. and that period shall in no case extend beyond the close of half year next after the half year during which the work or building has been actually completed or the plant provided.

(5) **Capitalisation of interest :**The said interest shall be charged to cost of building, work, plant.

Five important items which the auditor would examine while verifying payment of interest out of capital during construction :

Aspect	**The auditor should examine**	**Auditor's Duties**
Authorisation by Articles/ Special Resolution	Articles of Association (AOA)	Verify whether payment of interest out of capital during construction is authorised.
	Director's Minutes Book	Ascertain decision and send notice to share holders to pass a Special Resolution, where AOA do not permit such payment
	Member's Minutes Book	Confirm whether the Book Resolution has been passed as a special Resolution.
	Verify that the Special Resolution has be filed with the ROC.	
Central Government Approval	Verify that the previous sanction of the Central Government for making such payment has been obtained.	
Payment period	Verify that the interest is paid only for the period determined by the Central Government not exceeding 6 months after the half year in which the project has been completed.	
Interest Rate	Verify that the rate of interest does not exceed 12% p. a, or such other rate as may be prescribed by the Government.	
Financial Statement	Ensure whether the amount of interest so paid has been duly capitalized as a part of cost of work, or building or plant as the case may be. In case the asset is still under construction, verify whether the interest paid on such capital has been shown as "Miscellaneous 'expenditure'. Ensure that the payments made above has not been shown as a Reduction of Capital.	

QN (1) (c) Reserve and Provisions

Basis	***Reserves***	***Provisions***
Meaning	Schedule VI of Companies Act, 1956 has defined 'reserve' negatively as "It shall not include any amount written off or retained by way of providing for depreciation, renewals, or reduction in the value of assets or retained by way of providing for any known liability."	Schedule VI of Companies Act 1956 has defined 'provision' a. "any amount written off orretained by way of providing for depreciation, renewal or reduction in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. "
Nature	It is an appropriation of profit.	It is a charge on profit

Source	It is created out of profits.	It too is created out of profit. But it has also to be created even if there is no profit.
Aim	It is not created for determining true and fair view of profit or loss.	It is created for determining true and fair view of profit or loss.
Usage	It may be used for any other purposes other than those for which it was created.	It cannot be used for any other purpose for which it is not created.
Purpose	It is not created for the purpose of providing depreciation, renewals or reduction in the assets value or for a known liability whose amount cannotbe ascertained accurately and correctly.	It is treated for the purpose of providing depreciation, renewals or reduction in the assets value or for any known liability whose amount can be ascertainedaccurately and correctly.
Creation	It is optional to create general reserve.	It is compulsory to create provision
Duty of Auditor	Auditor does not needs to worry about the creation or adequacy of general reserve.	Auditor has to ensure the creation and adequacy of provision.

Qn (1) (d) As per SA 299 "Responsibility of Joint Auditors"(AAS 12) the work should preferably be divided by joint auditor if client has not divided the same. Sometimes natural division of work may not be possible. In such cases, the division of work should be on the basis of asset, liabilities, income, expense or on time basis. However if division is not made or their remains some common area, then joint auditor will perform work jointly. Co-ordination of joint auditor is essential. Each auditor should draw attention of other auditor to matters which requires discussion, further enquiry, disclosure or application of judgment. If any material fact is omitted in such case, then both joint auditors are RESPONSIBLE.

Therefore the statement that "Each joint Auditor is responsible only for the work allocated to him" is correct only when the division of work is done otherwise each of them are responsible for the common area.

Qn (2) (a)General consideration in framing a good system of internal check : Following points should be followed :

1. No single person should have an independent control over any important aspect of business. All dealings and acts of every employee should, in ordinary course of business, comes within review of other.
2. The duties of member of staff should be changed without any prior notice so that same officer or subordinate will not perform same function for a lengthy time.
3. Every member of staff should be encouraged to go on leave at least once in a year.
4. Persons having physical custody of assets must not be permitted to have access to books of accounts.
5. There should exist accounting control over each important class of asset. They should be periodically inspected so as to establish their physical existence.
6. To prevent loss or misappropriation of cash, mechanical devises, like automatic cash register should be employed.
7. There should be budgets prepared for each activity. These budgets should be compared with actual data. The job of comparison should be given to independent staff who is not connected with accounting staff. The material discrepancies should be reported and investigated.
8. For stock taking at end of the year, the trading activities should, in so far as possible, be suspended. The task of stock taking and evaluation should be done by a staff who is independent of stores department, accounts department. The members from various departments may be employed for stock taking.
9. The financial and administrative powers should be distributed among different officers in a proper manner and they should properly exercise them. A continuous review of their proper performance should be made.
10. Procedure should be laid down for periodical verification of accounting records of various department to ensure that they are accurate.
11. Accounting procedures should be periodically reviewed. At time they may cease to be effective.

Qn (2) (b)AUDIT PROCEDURE OF PAYMENT OF DIVIDEND

<table>
<tr><td>Procedure</td><td colspan="2">• First of all, dividend is recommended by the Board (Sec. 217).
• The members in the AGM may declare the dividend by passing OR. Declaration ofdividend at an AGM is an item of ordinary business (Sec. 173).
• The members may reduce the rate or amount recommended by the Board, but they cannot increase it.</td></tr>
<tr><td>Sources of dividend (section 205)</td><td colspan="2">Examine that dividend has been declared only out of:
(a) Profits of current FY
(b) Undistributed profits of previous FY(s)
(c) Moneys provided by CG or SG.</td></tr>
<tr><td>Provision for Depreciation</td><td colspan="2">Ensure compliance with following:
(a) Profits for every FY shall be arrived at after providing for depreciation.
(b) CG may allow a company to declare dividend for any FY without providing for depreciation.
(c) If in any previous FY, depreciation has not been provided, it shall be provided before declaring dividend.</td></tr>
<tr><td rowspan="7">Transfer to reserves</td><td colspan="2">Companies (Transfer of Profits to Reserves) Rules, 1975. Before declaration or payment of dividend, profits shall be compulsorily transferred to reserves at the following rates:</td></tr>
<tr><td>Rate of proposed dividend</td><td>Minimum amount to be transferred to reserves</td></tr>
<tr><td>Not exceeding 10%</td><td>Nil</td></tr>
<tr><td>Exceeding 10% but not exceeding 12.5%</td><td>2.5% of current profits</td></tr>
<tr><td>Exceeding 12.5% but not exceeding 15%</td><td>5% of current profits</td></tr>
<tr><td>Exceeding 15% but not exceeding 20%</td><td>7.5% of current profits</td></tr>
<tr><td>Exceeding 20%</td><td>10% of current profits</td></tr>
<tr><td>Mode of payment</td><td colspan="2">• Ensure that it is payable only in cash or by cheque.</td></tr>
<tr><td>Deposit of dividend</td><td colspan="2">• Examine whether it has been deposited in a separate bank account within 5 daysof declaration of dividend. Check bank statement w.r.t. same.
• The amount so deposited shall be used only for the purpose of payment of dividend (whether interim or final).</td></tr>
<tr><td>Dividend declared but remaining unpaid</td><td colspan="2">• Check that any dividend declared but remaining unpaid or unclaimed for 30 days from the date of its declaration has been transferred to unpaid dividend account.
• The transfer shall be made within 7daysto a special account in any scheduled bank to be called 'Unpaid Dividend Account of ... Company Limited/Company (Private) Limited'.
• Any money transferred to the unpaid dividend account of a company which remains unpaid for 7 yearsfrom the date of such transfer shall be transferred by the company to the Fund called 'Investor Education and Protection Fund'. Examine compliance with this requirement also.</td></tr>
</table>

QN (3) (a) Vouching of Retirement gratuity to employees

Retirement gratuity to employees **legal applicability** ↓ **basis** ↓ **check computation** ↓ **bank statements** ↓ **insurance policy** ↓ **acknowledgement** ↓ **AS-15**	1. Examine the relevant legal applicability or any contract entered into between employer & employee to check requirement to pay gratuity. 2. Ensure that basis of computation of gratuity is valid and as per prevailing laws, if any. 3. Check computation of gratuity with reference to number of years of service rendered by retiring employees. 4. Trace the relevant payment entry in bank statement. 5. If any insurance policy has been taken to fund gratuity liability, ensure that premium deposited has been taken to P&L Account. 6. Check acknowledgement from employee who got gratuity in relevant financial year. 7. Ensure compliance with AS-15

Qn (3) (b) APPOINTMENT OF AUDITOR BY PASSING SPECIAL RESOLUTION (224A)

In the case of a company in which not less than **25%** of the **subscribed share capital** is held, whether singly or in any combination by ;

i) A public financial institution or a Govt. Co. or a State Govt. or Central Govt.

ii) Any financial or other institution established by any provincial or state act in which a State Govt. holds not less than 51% of the subscribed share capital or

iii) A nationalised bank or

iv) An insurance company carrying on general insurance business.

the appointment/re-appointment at each AGM of an auditor shall be made by passing special resolution.

If SR is not passed it shall be deemed that no auditor had been appointed and hence CG (Regional Director) power becomes exercisable.

Duties of the company:The company shall give notice of that fact to CG.The notice shall be given within 7 days of conclusion of AGM.

Material date for reckoning 25% capital is the date of AGM and not the date of issue of notice : If at the time of issue of notice shareholding was less than 25% but before the date of meeting shareholding increased than the company should adjourn the meeting and should issue another notice to the members for appointment of auditor by special resolution. It should pass special resolution for appointment at the adjourned meeting.

Qn (3) (c) As per Section 293 of Companies Act, the following are the matters which only the shareholders can sanction at a General Meeting :

(a) sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking;

(b) remit, or give time for the re- payment of, any debt due by a director 2[except in the case of renewal or continuance of an advance made by a banking company to its director in the ordinary course of business];

(c) invest, otherwise than in trust securities, the amount of compensation received by the company in respect of the compulsory acquisition, after the commencement of this Act], of any such undertaking as is referred to in clause (a), or of any premises or properties used for any such undertaking and without which it cannot be carried on or can be carried on only with difficulty or only after a considerable time;

(d) borrow moneys after the commencement of this Act, where the moneys to be borrowed, together with the moneys already borrowed by the company (apart from temporary loans obtained from the company' s bankers in the ordinary course of business), will exceed the aggregate of the paid- up capital of the company and its free reserves, that is to say, reserves not set apart for any specific purpose; or

(e) contribute, after the commencement of this Act, to charitable and other funds not directly relating to the business of the company or the welfare of its employees, any amounts the aggregate of which will, in any financial year, exceed fifty thousand rupeesor five per cent. of its average net profits as determined in accordance with the provisions of sections 349 and 350 during the three financial years immediately preceding, whichever is greater.

Qn (4) (a) Going Concern Assumption : Under the Going concern assumption, an entity is viewed as continuing in business for the foreseeable future.
General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations.
When the use of the going concern assumption is appropriate, assets & liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

Some Financial Indications that may cast doubt about Going Concern Assumptions are :

1. Negative net worth or negative working capital.
2. Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets.
3. Adverse key financial ratios.
4. Substantial operating losses.
5. Substantial negative cash flows from operations.
6. Arrears or discontinuance of dividends.
7. Inability to pay creditors on due dates.
8. Difficulty in complying with the terms of loan agreements.
9. Change from credit to cash-on-delivery transactions with suppliers.
10. Inability to obtain financing for essential new product development or other essential investments.
11. Entering into a scheme of arrangement with creditors for reduction of liability.

Qn (4) (b) The following are some indication of doubtful and uncollectable debt, loans and advances :

(a) Terms of credit have been repeatedly ignored;
(b) There is no turnover or lack of healthy turn over in account;
(c) Payment are being received but balance is continuously increasing;
(d) Payments though being received regularly are quite small in relation to total O/S balance.
(e) An old bill has been partly/not paid but later bill are fully settled.
(f) The cheques received from debtors have been repeatedly dishonored.
(g) The debt is under litigation, arbitration or disputes.
(h) The auditor becomes aware of unwillingness or inability of debtors to pay dues, i.e. a debtor has either become insolvent, or has closed down his business, or is not traceable.
(i) Amount due from employees, which has not been repaid on terminationof employment.
(j) Collection is barred by statute of limitation.

Qn (5) (a) AUDIT OF EDUCATIONAL INSTITUTION /COLLEGE

Preliminary work	(1) Study the provisions of applicable statute as per the legal status of the institute. (2) Examine the trust deed or regulation. (3) Study the minutes of meetings of governing body / trustee to gain knowledge of any important decision which may affect the accounts for e.g., purchase of computer etc. (4) Evaluate the system of internal control. (5) Obtain list of accounting records & accounting policy adopted by the management.	
Receipts	**Fee from students**	(i) Check the admission fee to confirm whether amount has been creditedto a separate account. Refundable money is shown as liabilities. (ii) Check whether demands for fee are raised against all students. (iii) Ascertain whether the amounts demanded from student are as per rates specified according to their course. (iv) Verify the fee received by comparing fee collection register and copy ofreceipts issued to students, Forcheque received, examine passbook andfor cash received, check entries in cashbook. (v) Check authorisation for fee concessions. (vi) Ensure that in case of late payment of fee, fine has been properly imposed, collected & accounted for. (vii) Ascertain accounting &authorisation for fee received in advance. (viii) In case hostel facility is also granted to students, check whether hostel dues are properly demanded & collected on timely basis. Also ascertain whether all hostel dues have been properly accounted for.
	Rent	(i) Examine agreement with tenants to know rates of rent & their due dates etc. (ii) Verify rent received by comparing counterfoils of receipts issued with the bank pass book.
	Income on Investment	(i) Verify investment registers to check whether interest w.r.t. same has been duly accounted for. (ii) Interest and dividend received should be checked with reference to entries in bank pass book.
	Donations & grants	(i) Donations may be of two types, for specific use or for general use. Check recording of such amount in separate accounts. (ii) Vouch counterfoils of receipts issued to donors. (iii) Verify grant from government or any local authority with reference to sanction letter.
Expenses	**Towards students**	(i) Check the basis for providing scholarships to students, verifyacknowledgement letter from students. (ii) Examine payment w.r.t. prize distribution ceremonies. (iii) Examine whether expenses on books in library & sports item areproperly authorised& accounted for.
	Towards staff	(i) Examine the terms and conditions of salary to each category of staff. (ii) Check the calculation w.r.t. gross remuneration payable & deductionsthere from. (iii) Vouch payment made to teachers & other personnel with reference tobank pass book.
	Common Expenditure	(i) Vouch payment against electricity & water bill etc. (ii) Examine payments towards maintenance of hostel.

Assets	(i) Examine whether all fixed assets are properly accounted for. (ii) Verify ownership & existence of fixed assets by examining records & conducting physicalverification respectively. (iii) Verify whether depreciation has been properly calculated w.r.t each class of fixed assets. (iv) Obtain MRL w.r.t existence, ownership & valuation of assets.
Liability	(i) Verify corpus / capital fund with special attention to any increase in the same as compared to that of previous year. (ii) Check that any deposit paid by the student on admission, if refundable, is shown as a liability & not transferred to P&L account.

Qn (5) (b)Subsequent events – are thoseevents occurring between the date of financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report. No, all types of subsequent events is not considered by the auditor in his attest functions.

The auditor shall obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

The auditor shall:

(a) Obtain an understanding of any procedures management has established to ensure that subsequent events are identified.

(b) Inquiring of management and TCWG.

(c) Read minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements.

(d) Read the entity's latest subsequent interim financial statement's , if any.

If auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

If the above matters are not adjusted by the management in the financial statements, than the above matters should be considered by the auditor in his audit report.

QN (6) (a) The auditor should consider the following factors to examine whether the Internal audit system is commensurate with the size of the company and the nature of its business :

1. Financial year concerned means the financial year under audit.
2. This clause has a mandatory application for the listed companies irrespective of the size of paid-up capital and reserves or turnover.
3. In this regard, it is clarified that if the company is listed on a recognized stock exchange as on the date of the balance sheet, it should be considered as listed for the purpose of this clause.
4. This clause is applicable for the other companies which have a paid up capital and reserves exceeding Rs. 50 lacsas at the commencement of the financial year concerned, or having an average annual turnover exceeding five crores rupees for a period of three consecutive financial years immediately preceding the financial year concerned.
5. The following are some of the factors to be considered in this regard:
   (a) What is the size of the internal audit department?
   (b) What are the qualification of the persons who undertake the internal audit work?
   (c) To whom does the internal auditor report?
   (d) What are the areas covered by the internal audit?

Qn (6) (b) ADVANTAGES OF AN INDEPENDENT AUDIT

(1) It safeguard interest of persons who are not associated with mgt. of the concern, whether they are partners or shareholders.

(2) It acts as moral check on employees from committing fraud.

(3) Audited a/c's are helpful for Settlement of Tax disputes, negotiation of Loan , determination of purchase consideration of business.

(4) The audited a/c's are also useful in setting trade dispute for higher wages or bonus. Also claim for fire insurance etc may be settled through audited a/c's.

(5) An audit may help detection of wastage, and losses and locate reasons for their occurrence specially when they arises due to lack of efficient ICS and Internal Check System.

(6) Audit help in determining whether proper records have been maintained by client or not. This help client in correcting the books and records.

(7) Audit reviews existence and operations of various controls in organisation and reports weakness and deficiency located therein.

(8) Audited a/c's are helpful at time of Retirement/Admission of partners.

(9) Govt. may require audited a/c's before granting subsidy or license to a particular trade.

(10) Society is able to get an unbiased view which are useful for them to make significant economical decisions like shareholders, bankers, creditors etc.

(11) It is through audited a/c's only, that shareholders of a company are assured that funds invested by them are safe and they are being used for the purpose for which they had been raised. In company form of organisation, shareholder virtually have no control over day to day administration of company and it is only through audited a/c's that they are sure of their investment.

Qn (7)(a) Preliminary Expenses : These are incurred for the incorporation of a company. They may be paid by the promoters before the company is incorporated or by the company after it is incorporated. And they include the following:

a) professional charges paid for drafting of memorandum of association and articles of association;
b) professional charges for consultation in incorporating the company;
c) cost of printing of the initial copies of MoA and AoA;
d) stamp duty for the documents;
e) registration fee paid to the Registrar of Companies (RoC) for incorporation;
f) bank charges incurred on the above; and
g) incidental expenses such as stationary, conveyance, and so on.

Procedure to vouch Preliminary Expenses by the auditor :

1. Various preliminary expenses relating to the formation of an entity such as registration fees, cost of printing of documents, legal fees etc., should be checked with reference to bills and agreements.
2. Check receipt issued by lawyer, accountant and printing house.
3. Examine resolution of. BOD and the power in AOA, in case such expensesincurred by the promoters have been reimbursed to them.
4. Cross check the amount of preliminary expenses with that disclosed in theprospectus.
5. Check that no expense other than those constituting preliminary expenses areincluded under this head e.g. brokerage, underwriting commission.
6. Auditor should examine compliance with AS 26, with respect to accounting treatment of preliminary expenses.

Qn (7) (b) Initial Engagement : When the financial statements are audited for the first time or when thefinancial statements for the preceding period were audited by anotherauditor, than it is called initial engagement. In that case the auditor should follow Standard on Auditing (SA) so that hemay become aware of contingencies and commitments existing at thebeginning of the current period.

In an initial audit engagement, the auditor will not have previouslyobtained audit evidence supporting the **opening balances**, therefore he should obtain sufficientappropriate audit evidence that:

(a) the closing balances of the preceding period have been correctlybrought forward to the current period;

(b) the opening balances do not contain misstatements that materiallyaffect the financial statements for the current period; and

(c) appropriate accounting policies are consistently applied.

"Opening balances" means those account balances which exist at thebeginning of the period. Opening balances are the closing balances of thepreceding period brought forward to the current period and reflect the effectof:
(a) transactions and other events of the preceding periods; and
(b) accounting policies applied in the preceding period.

Qn (7) (c) The possible disadvantages of an audit programme are following :
a. The audit may be performed mechanically without reference to special circumstance of client. Unusual features of client business may be left. [Pacific Acceptance Corporation Ltd's case]
b. Additional procedure may be needed, but staff member's may restrict themselves to the programme.
c. Assistant's independent judgement or initiative may be restricted.
d. Inappropriate procedures may be taken up, which may not be necessary.
e. Audit programme may remain unchanged, which may not be useful.

Qn (7) (d) The followings are the Audit Techniques :i. inspection ii. observation iii. inquiry and confirmation iv. computationv. analytical review

i. Inspection : Inspection consists of examination of records, documents or tangible assets. Inspection of records and documents provide reliability about financial statement. Inspection of tangible assets is the method to obtain evidence regarding existence of asset but not necessarily their ownership.
ii. Observation : It means witnessing a procedure being performed by others. For example - auditors do not physically verify the stock generally. But he is present where management is taking physical verification of stock.

iii. Inquiry and confirmation : Inquiry consists of obtaining appropriate information from knowledgeable persons inside or outside the entity. Enquiry may be formal written enquiry addressed to third party and it may be informal oral enquiry addressed to person inside the entity. The purpose of making enquiry is to get information which auditor did not possess.
Confirmation means response to enquiry to confirm information contained in accounting records.
Example : An auditor writes a letter to debtor of client for confirming his balance. The writing of letter by auditor is enquiry. If the debtor send his account statement, it will be called confirmation.

iv. Computation : computation consists of checking of the arithmetical accuracy of source document and accounting records or performing independent calculations.

v. Analytical review : It consists of studying significant ratios and trend and investigating unusual fluctuations and items. It also includes investigation of variations when the ratio and trends gives informations which deviate from prediction.

Qn (7)(e)Simple Random Sampling : Incase of Simple Random Sampling all items have equal chances of selection.It may involve use of random number table. Following are the characteristics of Simple Random Sampling :
(i) Each item of population (for Eg. :- each debtor) has equal chance of selection.
(ii) It can be chosen by
- use of random number table,
- help of computer.
  - Picking up number in a random way.

(iii) Suitable for Homogeneous population (population having similar items). For example:- Debtors ranging from Rs. 5,000 to 15,000.