PAPER – 6 : AUDITING AND ASSURANCE

QUESTIONS

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

   a. There is no difference between the terms “external audit” and “statutory audit”.

   b. It is auditor’s responsibility to maintain adequate accounting system incorporating various internal controls.

   c. Fraud is more difficult to detect than error.

   d. An unqualified opinion in audit report is a guarantee as to the future viability of the company.

   e. The auditor of a company has a right to carry out surprise checks of transactions beyond the end of the accounting year for which he is reporting.

   f. Since client pays for the audit, the audit working papers belong to the client.

   g. Potential for individuals to gain unauthorized access to data or to alter data without visible evidence is not there in CIS systems.

   h. If auditor relies on the work of an expert and expresses an unqualified opinion, he should refer to the work of the expert in his report.

   i. A Government company cannot contribute amounts to a political party or to any person for political purpose.

   j. Evidence obtained by the auditor through judgmental sampling cannot be considered sufficient appropriate audit evidence.

2. List six documents or papers, which would normally be retained on the current audit file.

3. What are the two basic types audit tests? Give examples of each type and explain the purpose of each test.

4. As an auditor, how will you, verify the following:

   (a) Provision for Bonus

   (b) Debentures

5. In a manufacturing concern, the management suspects inclusion of ‘dummy workers’ in wage sheets. What would you, as an auditor, suggest to detect such frauds?

6. Write short note on cut-off procedures relating to inventories.

7. As an auditor, how will you verify the following:

   (a) Bills receivable

   (b) Capital commitments

   (c) Assets acquired on hire-purchase basis

8. Comment – The company produced photocopies of fixed deposited receipts as the original receipts were kept in the iron safe of the director finance who was presently out of the country on company business.

9. Give your opinion on whether the following persons can be appointed auditors of a limited company or not.

   (a) A firm of chartered accounts in practice, a partner of which is a secretary of the company.

   (b) A chartered accountant in practice owing Rs.500 to the company

10. Write a short notes on - Audit Trail.

11. What is Joint audit? Discuss whether the liability of joint auditor is joint or several.

12. Mention some situations where statistical sampling methods may not be appropriate.

13. State briefly the duty of the auditor with regard when a loss of Rs.3 lakhs on account of embezzlement of cash was suffered by the company and it was debited to salary account.

14. How would you proceed to check the misappropriation of cash in a trading concern ?

15. Write short notes on :

   (a) Qualified audit report

   (b) Disclaimer of opinion

16. Comment - The management requested your audit firm not to comment on valuation of inventory and realisability of certain debtors, as they had been covered in Director's Report.

17. (a) A sum of Rs.20,000 per month has been paid as remuneration to a director, who is not in whole-time employment of the company.

   (b) The interest of a director in a transaction, entered into by the company has not been disclosed in the records maintained by the company.

18. Describe the salient features of financial administration of local bodies.

19. How will you verify the following assets ?

   (a) Freehold land

   (b) Leasehold property

   (c) Building

20. Write a short note on – Errors of Commission.

21. How will you vouch and/or verify the following?

   (a) Research and Development expenses

   (b) Recovery of Bad Debts written off

(c) Goods sent out on Sale or Return Basis

(d) Borrowing from Banks

22. Explain the meaning of the term “subsequent events” as used in the Standard on Auditing (SA 560).

SUGGESTED ANSWERS/HINTS

1. a. **False:** “External audit” is a wider term than “statutory audit”. It will cover independent audits – whether voluntary audits/statutory audits.

   b. **False:** As SA 200, it is management’s responsibility and not auditor’s responsibility.

   c. **True:** Fraud is more difficult to detect than error. This is because fraud generally involves sophisticated and carefully organized schemes to conceal it such as forgery, deliberate failure to record transactions, intentional misrepresentations to the auditor.

   d. **False:** Auditor’s opinion (even an unqualified one) is not an assurance as to the future viability of the company as given in SA 200A.

   e. **True:** The auditor is appointed at the Annual General Meeting to hold office until the next Annual General Meeting. He is not appointed for a particular accounting year. Consequently, he has the right of examination of the accounts and records of the company at any time during the period covered by his appointment, in so far as it is necessary for the purposes of his report. He may, therefore, carry out surprise checks of transactions beyond the end of the accounting year for which he is reporting.

   f. **False:** Working papers are the property of the auditor. The client does not have a right to access the working papers of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to the client.

   g. **False:** Potential for individuals to gain unauthorised access to data or to alter data without visible evidence may be greater in CIS than in manual systems.

   h. **False:** When expressing an unqualified opinion, the auditor should not refer to the work of an expert in his report. If, as a result of the work of an expert, the auditor decides to express other than an unqualified opinion, it may in some circumstances benefit the reader of his report if the auditor refers to or describes the work of the expert. Where, in doing so, the auditor considers it appropriate to disclose the identity of the expert, he should obtain prior consent of the expert for such disclosure if such consent has not already been obtained.

   i. **True:** Section 293A of the Companies Act, 1956 prohibits Government company from contributing amounts to a political party or to any person for a political purpose.

j. **False:** The rates of depreciation prescribed by Schedule XIV to the Companies Act, 1956 are the minimum rates to be charged. AS 6 notified under section 211(3C) of the Companies Act, 1956 also states that rates lower than statutory rates cannot be charged unless permitted by the statute itself.

2. Following six documents or papers, which would normally be retained on the current audit file:
   - Correspondence relating to acceptance of annual re-appointment.
   - Extracts of important matters in the minutes of the board meetings and general meeting as are relevant to audit (e.g. minutes relating to declaration of dividend).
   - Audit plan and audit programme.
   - Analysis of transactions and balances (e.g. age-wise analysis of debtors).
   - Record of audit procedures and their results (e.g. test checking of purchase invoices to vouch payments for purchases).
   - Evidence regarding the supervision and review of the work of assistants.

3. The two types of audit tests are as follows:

   1. ***Compliance test:*** A compliance test is a test which seeks to provide audit evidence that the internal control procedures are being applied as prescribed.

      Example:

      (i) Checking for authorisation on a credit note: This should confirm that all credit notes are suitably authorised before being issued.

      (ii) Checking for the casting stamp on a purchase invoice: This should confirm that all invoices are cast before being paid.

      (iii) Checking that copy of goods dispatched notes are attached to the copy of sales invoices: This should confirm that invoices would only be posted to the sales ledger after the goods have been dispatched.

   2. ***Substantive test:*** A substantive test is a test of a transaction or balance, which seeks to provide audit evidence as to the completeness, accuracy and validity of the information contained in the accounting records or financial statements.

      Example:

      (i) Circularisation of debtors to confirm the accuracy of the balance on the sales ledger.

      (ii) Checking the positing of day-book totals to the nominal ledger, which should confirm accuracy of posting.

      (iii) Matching a purchase invoice with the original order and goods received note to confirm that the purchase is bonafied.

4. (a) *Provision for bonus* – Provision for bonus can be verified by adopting following audit procedures –

   (i) Examine whether the amount for bonus has been provided for in accordance with the Payment of Bonus Act and/or agreement with the employees or award of competent authority.

   (ii) In cases where the amount of the provision is in excess of the amount required to be paid as per the aforesaid Act/agreement/ award, the auditor should examine authority for such excess payments.

   (iii) Examine the relevant documentary evidence to vouch the bonus payment during the year e.g. bank statements, salary slips, etc.

   (b) *Debentures* – The auditor may adopt the following procedures to verify debentures

   (i) Examine the memorandum and articles of the company to ascertain the borrowing powers of the company and limitation thereon, if any.

   (ii) Vouch the cash received from the issue of debentures with the cash book, bank statement, application and allotment book and register of debenture holders.

   (iii) Examine the list/register of debenture holders and ensure that the total amount received from debenture holders agrees with the total amount of debentures shown in the balance sheet.

   (iv) Examine debenture trust deed in order to ascertain the terms and conditions of the issues.

   (v) Ensure compliance with provisions of the Companies Act such as section 117B (appointment of debenture trustees and his duties) and section 117C (creation of a security and debenture redemption reserve), SEBI guidelines and listing requirements, if any.

   (vi) Examine register of charges to ensure that charge created has been properly registered.

   (vii) Ensure that the provisions regarding redemption of debentures have been adhered to.

5. Effective and appropriate internal control system should be adopted in order to detect the inclusion of the names of dummy workers in the wage sheets. The application of suitable internal check system, however, depends on the nature and procedures of wage payment of the factory concerned. However, following outlines of the system can be suggested.

   (a) Each worker should be provided with a time card or job card as the case may be. Proper records in detail about each worker must be maintained in such cards. The foreman in charge should initial the entries in the cards. At the end of the week or month, the card should be sent to wage office.

   (b) Due care should be given in the preparation of wage sheets. Wage sheets should not be prepared by those employees, who are responsible for recording the attendance of the workers. The work of wage sheet preparation should be assigned to a number of employees in such a way that the work done by one is automatically checked by the other.

(c) Payment of wages should not be made by those employees, who have taken part in the preparation of wage sheet. It should be done by the cashier in the presence of a responsible officer and also the foreman, who can recognise the workers.

(d) Proper records related to overtime authorised and granted to the workers must be maintained. For casual workers, separate records should be maintained.

6. The auditor should examine that the entity has instituted appropriate 'cut-off' procedures for inventory to ensure that at the financial year end transactions are posted to the relevant period to which they relate. He should ensure their efficacy by the following audit procedures –

(i) Examine invoices (relating to purchase and sales) and credit notes relating to raw materials and finished goods posted to the books of account during the last few days preceding the financial year and the first few days following the financial year and should be matched with the entries in the stock records to ensure that they are entered in the correct periods.

(ii) Ensure stocks represented by such documents were included or excluded, as appropriate during stocktaking.

(iii) Calculate the gross profit percentage, ratio of creditors to purchases and ratio of debtors to sales to assess whether unusual fluctuations exist. If it does, then it implies errors or frauds relating to cut-off may be there, which, in turn necessitate extensive substantive procedures by the auditor.

7. (a) *Bills receivable* – The auditor should examine the internal control system with regards to bills receivable and he may adopt the following audit procedures to verify bills receivable –

(i) Verify the opening balance of bills receivable with reference to audited balance sheet of the last year.

(ii) Examine the transactions recorded in the bills receivable book with reference to the relevant documentary evidence such as covering note sent by the customer along with payment on maturity of the bill, covering note issued by the ban on discounting etc.

(iii) Carry out a physical verification of the bills receivable on hand as at the end of the year. Ensure they are properly drawn, stamped, duly accepted and not overdue for payment.

(iv) If bills have been discounted with bank, then they should be verified with reference to confirmation obtained from the bank and entries in the cash book. Contingent liabilities in respect of such bills should be shown as a footnote to the balance sheet.

(v) If some bills have been dishonoured, the auditor should ensure adequate provision has been made for irrecoverable amount. Ensure the concerned party has been informed of the dishonour of its bill.

(vi) Ensure that bills which have been matured but the amount in respect thereof has not been received, have been renewed subsequently.

(b) *Capital commitments* - Capital commitment is the amount of capital expenditure on fixed assets which management wants to spend in near future. It is disclosed as a note to the balance sheet. The auditor should --

(i) Examine the minutes of board's meetings, purchase order and agreement, if any, with respect to capital commitments.

(ii) Obtain a management representation to this effect.

(iii) Ensure that notes to the balance sheet clearly mention the contracted value of the capital expenditure and the amount already disbursed, if any.

(c) *Assets acquired on hire-purchase basis* – The procedures which may be adopted by the auditor to verify such assets are --

(i) Examine the relevant contract to determine the provisions as to method, time duration, etc. to payment and the title.

(ii) Ensure proper valuation and disclosure i.e.

- The said asset should be shown as its net cash purchase price.
- Initial finance charges such as file charges and interest charged in advance should not be capitalized but should be charged to revenue account on becoming due.
- The total purchase price less down payment i.e. total unpaid balance should be shown as liability in the balance sheet under secured loans.
- Alternatively, only the capital portion of the installment paid upto the date of balance sheet can be debited to plant and machinery account and interest included in each installment charged to profit and loss account as expense.
- Depreciation should be computed on entire asset cost and not merely with respect to paid amounts.

8. (i) According to the Guidance Note on Investment issued by the ICAI, the auditor should physically inspect all securities in which money has been invested during the year to verify existence and ownership of such investments.

(ii) The auditor should not, therefore, accept photocopies and may choose to give disclaimer of opinion in his audit report.

9. (a) As one of the partners of the firm is the secretary of the company, the firm cannot be appointed as the auditors of the company. A secretary is an employee of the company and according to Section 226(3b) of the Companies Act, 1956, an employee of the company cannot be appointed its auditor.

(b) He can be appointed as an auditor of the company as he is indebted to the company for an amount of Rs.500 only, i.e. less than Rs.1,000. According to Section 226(3d) of the Companies Act, 1956, a person who owes to the company an amount exceeding Rs.1,000 cannot be appointed as an auditor of the company.

10. Audit Trail: An audit trail refers to a situation where it is possible to relate 'one-to-one' basis, the original input along with the final output. The work of an auditor would be hardly affected if "Audit Trail" is maintained i.e. if it were still possible to relate, on a 'one-to-one' basis, the original input with the final output. A simplified representation of the documentation in a manually created audit trail.

For example, the particular credit notes may be located by the auditor at any time he may wish to examine them, even months after the balance sheet date. He also has the means, should he so wish, of directly verifying the accuracy of the totals and sub-totals that feature in the control listing, by reference to individual credit notes. He can, of course, check all detailed calculations, casts and postings in the accounting records, at any time.

In first and early second-generation computer systems, such a complete and trail was generally available, no doubt , to management's own healthy skepticism of what the new machine could be relied upon to achieve – an attitude obviously shared by the auditor.

It is once again clear from the diagram that there is an abundance of documentation upon which the auditor can use his traditional symbols of scrutiny, in the form of coloured ticks and rubber stamps. Specifically:

(i) The output itself is as complete and as detailed as in any manual system.

(ii) The trail, from beginning to end, is complete, so that all documents may be identified by located for purposes of vouching, totalling and cross-referencing.

Any form of audit checking is possible, including depth testing in either direction.

11. Meaning of Joint Audit

An audit is said to be joint audit when two or more persons or firms of chartered accountants are jointly appointed to conduct the audit of a company. The practice of appointing joint auditors has been adopted by large sized companies, which want to pool the resources of two or more auditors so that the audit work may be undertaken effectively and quickly. The joint auditors stand on equal footing so far as the professional work of audit is undertaken by them.

Liabilities of joint auditors

Section 227 of the Companies Act, 1956 does not contemplate any division of work of audit between two or more persons. Thus, according to the provisions of this section, the joint auditor has an individual responsibility only. Also, it is not quite proper to hold an auditor responsible for the work not done by him. If there are two auditors and both of them are held responsible jointly, that would create many practical problems.

While the Companies Act is silent on this issue, the Institute of Chartered Accounts of India has issued a "Statement on the Responsibility of Joint Auditors". In this statement, it has been made clear that it would not be correct to hold an auditor responsible for the specifically allotted work of another. Each joint auditor will be held responsible only for the work allocated to him. According to the statement, we cannot hold an auditor responsible for the work done by another auditor who is equally qualified and competent to undertake the audit work. This also makes it clear that where the work cannot be clearly divided, the responsibility will be jointly shared between them.

12. The auditor may not find statistical sampling methods appropriate in following situations –

    (i) Population is small.

    (ii) Population is diverse and cannot be divided into strata or clusters.

    (iii) Internal control system is weak i.e. control risk is high.

    (iv) Benefits do not exceed cost.

    (v) Exact accuracy is required.

    (vi) Materiality considerations i.e. item is material because of legal requirements or susceptibility of misstatements due to fraud or error.

13. (i) AS-5 Net Profit or Loss for the Period Prior Period items and Changes in Accounting Polices – "requires that (income and) expenses within (profit or) loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

    (ii) Embezzlement of cash of Rs.3,00,000 is an ordinary business loss which as per the requirements of AS 5 should be disclosed separately in the profit and loss account. It should not be merged with salary.

14. Types of cash misappropriation

    Cash can be misappropriated in a trading concern by various methods. Some of these are as under:

    (a) *Sales and cash receipts*

        (i) Teeming and lading;

        (ii) Overstatement, understatement or omission of sales and other revenue items.

    (b) *Purchases and cash payments.*

        (i) Kiting;

        (ii) Submission of false invoices

    (c) *Wages*

        (i) Inclusion of 'dummy workers';

        (ii) Misappropriation of unclaimed cheques / pay envelopes.

Steps to proceed to check the misappropriation of cash

(i) Study and evaluation of internal control system – The auditor should study and evaluate the internal control system with regard to cash receipts and cash payments.

A sound internal control system for cash receipts should consist of –

- an internal check system which segregates the functions of all employees clearly
- clearly laid down authorisation procedures which should ensure that transactions are authoris ed by management personnel acting within the scope of their authority
- adequate physical controls such as limited access, numerical series on internal documents, etc.

(ii) Vouching of cash receipts – The usual vouching procedures for cash receipts are discussed below:

(a) Examine cash book: The auditor should examine cash book with reference to relevant documentary evidence, for example – carbon copies or counterfoils of cash receipts, letters of confirmation for verifying balances outstanding against debtors' name, tenancy agreement (in case of rent received), broker's sold note (in case of sale of investments), etc.

(b) Examine the counterfoils of pay-in-slips: The auditor should compare the dates on the counterfoils of pay-in-slips relating to deposit of cash/cheques/drafts into the account with the dates entered in the cash book and should enquire into the causes of delay, if any.

(c) Examine the carbon copies of receipts: The auditor should examine the carbon copies of cash receipts which are issued as acknowledgement by the entity.

(d) Routine checking: The auditor should examine the arithmetical accuracy of cash book, carbon copies of cash receipts and counterfoils of pay-in-slips and posting of transaction from the cash book to relevant ledger accounts.

(iii) Vouching of cash payment: The general vouching procedures in respect of cash payments are mentioned below:

(a) Examine the payments in the cash book: The auditor should examine the entries in the cash book with reference to the relevant payment vouchers. He should pay special attention to details such as –

- The date, amount, serial number, account head, validity and arithmetical accuracy of the voucher.
- Voucher should be supported by relevant documents.

- The auditor should examine whether the cash memo against which payment has been made is in the name of the client, payment relates to the nature of business, goods/services mentioned therein, are in conformity with specifications by the client and cash memo pertains to the period under audit.
- The payment has been classified properly between capital expenditure revenue expenditure.
- The payment is properly authorised.

(b) *Examine the bank statement:* In case of payments made by cheques, the auditor should examine the numerical sequence of cheques issued and ensure missing numbers are properly accounted for.

(c) *Routine checking:* The auditor should perform routine checks to establish the arithmetical accuracy of the cash memos and the cash book by verifying the totals, balances and carry forward of balances with the corresponding accounts in the ledgers.

15. (a) *Qualified audit report:* Qualified audit report is a report wherein the auditor has expressed a qualified opinion, that is to say, an opinion subject to certain reservations.

Important aspects in relation to qualifications in an audit report are mentioned below:

(i) The auditor should give a qualified opinion when the subject-matter of qualification is not highly material and pervasive and he believes that the overall financial statements give a true and fair view.

(ii) A qualification should be preceded by the words 'subject to' or 'expect that' to make it clear that the matter is of exceptional nature.

(iii) The audit report should quantify the effect of individual qualifications and also the total effect of all qualifications on the financial statements. If precise quantification is not possible the auditor can use estimates made by the management after applying proper audit tests. The report should clearly mention the fact of reliance on such figures.

(iv) The auditor shall state the reasons for his qualification.

(v) In case of a limited company, if any of the statutory affirmations in section 227(2) and section 227(3) are answered in negative or with qualification by the auditor; the audit report would be termed as a 'qualified audit report'.

(vi) Qualifications which deal with matters, which have an adverse effect on the functioning of the company should be in thick type or in italics.

(b) *Disclaimer of opinion:* The auditor issues a disclaimer of opinion if the subject-matter involved is material and pervasive and he is unable to obtain sufficient appropriate evidence to express an opinion on it. A disclaimer can result because material and pervasive uncertainties could not be resolved, there is going-concern doubt or there is a material limitation on the scope of the audit.

The uncertainty or the ability of an entity should be such as to make it difficult to determine whether assets should be valued at going-concern or liquidation values.

16. (a) Legal requirements – Sections 217, 222 and 227

- As per section 217 board's report is 'attached to' a balance sheet. Sections 227(2) and (3) requires auditors only to report on the documents 'annexed to' financial statements.
- But section 222 has provided that any information, which is required to be given in accounts or in a statement annexed to accounts, may be given in the board's report instead of in the accounts. In such circumstances, the board's report shall be annexed to accounts ('not attached to'). The auditor should in this case, report on the matters reported upon by the directors.

(b) In the present situation as per the requirements of section 222 the auditor has a duty to report on the Board's report. Therefore, he should not accept their contention and verify the debtors and inventory by adopting appropriate audit procedures.

17. (a) (i) Legal provision

- Under section 309(4) of the Companies Act, 1956 a director who is not in whole-time employment of the company nor is the managing director may be paid remuneration on a monthly/quarterly/ annual basis with the approval of the Central Government or by way of commission if the company by special resolution authorises such payment.
- The remuneration paid to such director/(s) shall not exceed –
  - one per cent of the net profits of the company, if the company has a managing or whole-time director or a manager;
  - three per cent of the net profits of the company, in any other case.

However, the company in a general meeting with prior approval of the Central Government may exceed the above rates.

(ii) Present case

In the given case, auditor should examine the compliance to above mentioned provisions.

(b) (i) Legal and professional perspective

- Section 301 of the Companies Act, 1956 requires the company to maintain a Register of transactions with parties with which directors are interested.
- CARO, 2003 also requires the auditor to report whether the particular of contracts or arrangements referred to in section 301 of the Act have been entered in the register maintained under this section and whether

transactions exceeding rupees five lakhs in respect of any such party have been made at reasonable prices.

- The SA 550, "Related parties" has prescribed the procedures for identification and verification of related parties and their transactions and auditor's responsibility in this regard.

(ii) Present case

In the given situation, since the register under section 301 does not disclose the interest of a director in a transaction, the auditor should qualify his report under sections 227(2) and (3) of the Act. If CARO 2003 is also applicable to the company, the auditor should qualify the report thereunder also.

18. (i) Budgetary procedure

(a) *Objective* – The objectives of local bodies budgetary procedure are :

- Financial Accountability,
- Control of expenditure, and
- To ensure that funds are raised and money is spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorisation by the Legislature or council.

(b) *Aspects* – The aspects covered in budgeting are :

- Determining the levels of taxation e.g. various types of taxes, fees and rates; and
- Laying down the ceilings on expenditure, under revenue and capital heads.

(ii) Expenditure controls

(a) At the State and Central Government level, there is a clear demarcation between the Legislature and executive. In a local body, legislative powers are vested in the Council whereas executive powers are delegated to the Officers e.g. Commissioners.

(b) All matters of regular revenues and expenditures are generally delegated to the executive wing. For special situations like reduction in property taxes, refunds of security deposits etc., sanction from the legislative wing, i.e., the Municipal Council will have to be obtained.

(iii) Accounting system

(a) Municipal accounting system has been conventionally prepared under the cash system. In the recent past however, it is being changed to the accrual system of accounting in some States like Tamil Nadu.

(b) The accounting system is characterised by –

- Subsidiary and Statistical Registers for taxes, assets, cheques, etc.;
- Separate vouchers for each type of transaction;

- ➢ Compulsory monthly bank reconciliation;
- ➢ Submission of summary reports on periodical basis to different authorities at regional and State level.

19. (a) *Freehold Land* : The auditor should follow the audit procedures mentioned below to achieve the objects of verification of freehold land.

Objective	Audit Procedure
(i) Existence and ownership	• Inspect original title deeds and conveyance or purchase deed which should be in the name of the client. • Vouch payments in case new land has been purchased during the year.
(ii) Possession and determine liens, if any	• Title deed should be in custody of owners. • In the case of mortgage, obtain a certificate from mortgagee or his lawyer confirming the possession of the title deed. • If any charge or encumbrances exist on land, the auditor should ensure they have been properly disclosed.
(iii) Valuation and disclosure	• Land is a non-depreciable asset. It is, generally, shown in the balance sheet at historical cost which includes purchase price, broker's commission, stamp duties, registration fees, legal charges and also levelling, clearing and draining charges. • Where payments are made to the municipality for constructing side-walks, laying of sewers, etc. such costs should, preferably, be shown separately in 'Land Improvement Account' and adequate depreciation should be provided for on it.

The following documents to be inspected are: title deeds, conveyance or purchase deed, certificate from mortgagee or his lawyer, minutes book or resolutions.

(b) *Leasehold Property* : A lease is an agreement between a lessor and lessee for the use of property for a certain period or in perpetuity against some consideration. The auditor may adopt the following procedures to verify leasehold property:

Objective	Audit Procedure
(i) Existence and ownership possession	• Examine the lease deed to ascertain its terms and conditions. • Ensure that it is registered with the Registrar. • Ensure compliance with important conditions such as

	payment of rent on due dates, maintenance of property etc. stated in the deed.
(ii) Determine liens, if any	• Leasehold property cannot be subject to lien. However, it may be sublet. In such a case, the auditor should examine the tenants' agreements.
(iii) Valuation and disclosure	• It should be valued at cost less depreciation cost includes the capital outlay as well as legal expenses incurred to acquire the lease.

(c) *Building* : The audit procedures for verification of building are given below:

Objective	Audit Procedure
(i) Existence, ownership, possession and determine liens, if any	• The audit procedures followed for ascertaining the existence, ownership and possession are similar to those of freehold land. • The extent of liens against building can be determined by examining records and obtaining proofs similar to freehold.
(ii) Valuation and disclosure	• Buildings should be valued at cost less depreciation. • In case land and building have been purchased together ensure that cost has been segregated for depreciation purposes on a reasonable basis. • Ascertain the reasonableness of basis used to calculate the cost if building is purchased or constructed. • In case of revaluation, depreciation should be provided at revalued amount as reduced by estimated residual value.

20. Errors of Commission: When a transaction has been misrecorded either wholly or partially it is called as a error of commission. Error of commission can happen in the following ways:

Errors in posting,

Errors in Casting,

Errors in carrying forward,

Errors occurring during extraction of balances, etc.

Posting errors may be of a wrong account, wrong amount or wrong file. For example, amount received from Mr X and credited to Mr Y, purchase of Rs.360 from Mr A posted in his account at Rs.630 or sales returns from Mr X posted as the debit of his account, etc.

The first type of errors will not affect the trial balance, however, the other two will affect the agreement of trial balance.

Casting errors are the errors committed while making the totals. This error affects the trial balance.

Error of carry forward and errors of extraction of balances also affect the trial balance.

Error of duplication is another type of error of commission which means recording the same transaction twice.

errors however, do not affect the trial balance but they will affect the Profit and Loss A/c (over statement of expenditure).

21. (a) Research and Development Expenses

(i) Ascertain the nature of research and development work at the outset and enquire whether separate Research and Development Department exists.

(ii) See allocation of expenses under revenue and deferred revenue. Ensure that expenses which are routine development expenses are charged to Profit and Loss Account.

(iii) Check whether the concerned research activity is authorised by the Board and has relevance to the objectives of the company.

(iv) Examine that generally research expenses for developing products or for inventing a new product are treated as deferred revenue expenditure to be written off over a period of three to five years, if successful. In case it is established that the research effort is not going to succeed, the entire expenses incurred should be written off to the profit and loss account.

(v) Ensure that if any machinery and equipment have been bought specially for the purpose of research activity, the cost thereof, less the residual value should be appropriately debited to the Research and Development Account over the years of research.

(b) Recovery of Bad Debts written off

(i) Ascertain the total amount of bad debts.

(ii) Ensure that all recoveries of bad debts have been properly recorded in the books of account.

(iii) Examine notification from the Court or from bankruptcy trustee, letters from collecting agencies or from debtors should also be seen.

(iv) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.

(c) Goods sent out on sale or return basis

(i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.

(ii) See that price of such goods is unloaded from the sales account and the debtor's record. Refer to the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.

(iii) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited.

(iv) Confirm that the stock of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing stock.

(d) Borrowing from Banks: Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows:

(i) Reconcile the balances in the overdraft or loan account with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.

(ii) Obtain a certificate from the bank showing particulars of securities deposited with the bank as security for the loans or of the charge created on an asset or assets of the concern and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.

(iii) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.

(iv) Confirm, in the case of a company, that the restraint contained in Section 293 of the Companies Act, 1956 as regards the maximum amount of loan that the company can raise has not been contravened.

Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

22. (a) Meaning of Subsequent Events: *SA 560* on "Subsequent Events", defines the term 'subsequent events" as those significant events which occur between the balance sheet date and the date of the auditor's report. In the case of an audit of a component, such as a branch or division, of an entity, "subsequent events" also refer to significant events which occurred up to the date of report of the auditor of that component. Thus, subsequent events are those events which occur after the date of the balance sheet till the audit report is signed by the auditor.

(b) Consideration of Subsequent Events by the Auditor: *SA 560* requires that the auditor should consider the effect of subsequent events on the financial statements and the auditor's report. However, the exact manner of treatment would depend upon whether the event falls in the category of 'adjusting event' or 'non-adjusting event'. As per Accounting Standard (AS) 4, events occurring after the date of the balance sheet are of two types, viz., adjusting events which provide further evidence of conditions that existed at the date of the balance sheet; and, non-adjusting events are those which are indicative of conditions that arose subsequent to the date of the balance sheet.

Therefore, an auditor is required to consider all subsequent events while discharging his duties and determine whether those shall have to be adjusted or simply required to be disclosed. However, the auditor should perform work as near as practicable to the date of the auditor's report.

23. Auditor's Lien: In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property.

On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.

The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:

(i) Documents retained must belong to the client who owes the money.

(ii) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.

(iii) The auditor can retain the documents only if he has done work on the documents assigned to him.

(iv) Such of the documents can be retained which are connected with the work on which fees have not been paid.

Under Section 209 of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. However, in both the Act, further provisions are thereunder which books of account could be kept at a different place, pursuant to a Board resolution of which notice must be given to Registrar of Companies.

If in a company Board passes such a resolution and hands over the books of account to the auditor and makes the necessary notification to the Registrar of Companies. If in a company Board passes such a resolution and hands over the books of account to the auditor and makes the necessary notification to the Registrar, the auditor may in such circumstances, exercise the right of lien for non-payment of fees.

However, as per Section 209 he must provide reasonable facility for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints.

His working papers being his own property, the question of lien, on them does not arise.

The SA 230 issued by ICAI on "Audit Documentation" also states that, "working papers are the property of the auditor". The auditor may at his discretion make portions of or extracts from his working papers available to his clients.

Thus, documents prepared by the professional accountant solely for the purpose of carrying out his duties as auditor (whether under statutory provisions or otherwise) belong to the professional account.

In the case of *Chantrey Martin and Co. v. Martin,* it was held that the following documents were the property of the auditor: working papers and schedules relating to the audit, draft accounts of the company, and the draft tax computation prepared by an employee of the auditor.

It is also clear that the accountant's correspondence with his client (letters written by the client to the accountant and copies of the letters written by the accountant to the client) belong to the accountant. In the case of *Chantrey Martin and Co. v. Martin*, it was also held that the correspondence between the accountant and the taxation authorities with regard to the client's accounts and tax computations was the property of the client since the accountant merely acted as agent of the client.

However, where the accountant communicates with third parties not as an agent, but as a professional man, e.g., as an auditor, the correspondence with third parties would seem to belong to the accountant. According to the statement, where an auditor obtains documents confirming the bank balance or confirming the custody of securities of the client or other similar documents, it is probable that the courts would hold that these documents belong to the auditor.

24. Reserves and Provisions

Reserves : Reserve denotes retained profits. In other words, certain sum or sums are set apart out of the profits earned for specific or general purposes, and this constitutes reserve (or reserves).

These reserves are not available for dividend purposes in the year concerned. However, subject to decision of the Board of Directors, there can be appropriation out of reserves created in the past for dividend purposes, provided such reserves are not capital reserves.

If there is no profit, no reserve can be created and, basically, reserves are at the disposal of the undertaking; they are not required to be maintained for meeting possible losses or expenses. The term "reserve" has been negatively defined in Part III of Schedule VI to the Companies Act, 1956 as not including any amount written off or retained by way of providing for diminution, renewals or diminution in value of assets or retained by way of providing for any known liability.

Provision: Provision, on the other hand, represents a charge for an estimated expense or loss or for a shrinkage in the cost of an asset or the accrual of a liability.

Except for provision for dividend which is appropriation of profits, provisions are meant to meet expected losses and expenses for which the amount is uncertain.

Profit cannot be ascertained unless the necessary provisions are first made. Part III of Schedule VI to the Companies Act, 1956 has defined "provision" to mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. Amounts provided for depreciation, renewals or diminution in value of assets are expenses and losses.

Hence, the character of provision is of an expense or loss which must be charged against the revenue so as to arrive at the true and fair profit or loss. Since reserve is retained profit, it is necessarily an appropriation of profit obtained after charging all the expenses and losses including provisions. It, therefore, cannot include anything which is properly chargeable as expense or loss, i,.e., provision.

However, if amounts are provided in excess of the needs, the excess should be treated as reserve. For example, the company may provide for depreciation at the rate of 25% as against the statutory rate of 15%. The excess of depreciation to the extent of 10% would be treated as reserve even though the entire 25% has been a charge to the profit and loss account. For creation of reserve, existence of profit is a must while provision is necessary even where there is a loss so as to correctly reflect the operating results of the enterprise.

25. (a) SA 510 on, "Initial Engagements-Opening Balances", establishes standards regarding audit of opening balances in case of initial engagements, i.e., when the financial statements are audited for the first time or when the financial statements for the preceding period were audited by another auditor. It requires that the auditor should obtain sufficient appropriate audit evidence for initial audit engagements that:

(i) the closing balances of the preceding period have been correctly brought forward to the current period;

(ii) the opening balances do not contain misstatements that materially affect the financial statements for the current period; and

(iii) appropriate accounting policies are consistently applied.

As far as sufficiency and appropriateness of the audit evidence is concerned, the auditor needs to obtain regarding opening balances, would depend on the following matters:

(i) The accounting policies followed by the entity.

(ii) Whether the auditor's report contained an unqualified opinion, a qualified opinion, adverse opinion or disclaimer of opinion where the financial statements for the preceding period were audited.

(iii) The nature of the opening balances, including the risk of their misstatement in the financial statement for the current period.

(iv) The materiality of the opening balances relating to the financial statements for the current period.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

(b) Should all type of subsequent events be considered by the auditor in his attest function?

List of Institute publications - November, 2009

I. Statements and Standards

1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.

2. Standards on Auditing as given below

S.No. Standards on Auditing and Number (All these SAs have been hosted in the Institute's Website).

1. Basic Principles Governing an Audit (SA 200)
2. Objectives and Scope of the Audit of Financial Statements (SA 200A)
3. Terms of Audit Engagement (SA 210)
4. Quality Control for Audit Work (SA 220)
5. Audit Documentation (230) (Revised)
6. The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (SA 240) (Revised)
7. Consideration of Laws and Regulations in an Audit of Financial Statements (SA 250) (Revised)
8. Communication of Audit Matters with Those Charged with Governance (SA 260) (Revised)
9. Responsibility of Joint Auditors (SA 299)
10. Planning an Audit of Financial Statements (300)
11. Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment (SA 315) (Newly issued)*
12. Audit Materiality (SA 320)
13. The Auditor's Responses to Assessed Risks (SA 330) (Newly issued)*
14. Audit Considerations Relating to Entities Using Service Organisations (SA 402)

15. Audit Evidence (SA 500)
16. Audit Evidence - Additional Considerations for Specific Items (SA 501)
17. External Confirmations (SA 505)
18. Initial Engagements – Opening Balances (SA 510) (Revised)
19. Analytical Procedures (SA 520)
20. Audit Sampling (SA 530) (Revised)
21. Auditing of Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures (SA 540) (Revised)
22. Related Parties (SA 550) (Revised)
23. Subsequent Events (SA 560) (Revised)
24. Going Concern (SA 570) (Revised)
25. Written Representations (SA 580) (Revised)
26. Using the Work of Another Auditor (SA 600)
27. Relying Upon the Work of an Internal Auditor (SA 610)
28. Using the Work of an Expert (SA 620)
29. The Auditor's Report on Financial Statements (SA 700)
30. Comparatives (SA 710)

Note 1:

* Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (erstwhile AAS 1) and SA 200A (erstwhile AAS 2) will be merged into one Standard, i.e. SA 200.)

** SA 315 & SA 330 – become effective in April, 2008. For November 2009 Final (Old) Examination 34 standards on Auditing as given in the Annexure – I. The Standard on Auditing (SA) 400, "Risk Assessments and Internal Control", SA 310, "Knowledge of the Business", and SA 401, "Auditing in a Computer Information Systems Environment", issued in June 2002, April 2000 and January 2003, respectively, would stand withdrawn.

Note 2:

Newly issued SA 450 "Evaluation of Misstatements Identified during the Audit"Effective for all audits relating to accounting periods beginning on or after April 1, 2010. It is not applicable for the November, 2009 examination.

3. Statement on Reporting under Section 227(1A) of the Companies Act, 1956
4. Statement on the Companies (Auditor's Report) Order, 2003 [2005 Edition].

II. Guidance Notes/Study Guide/Monograph

Guidance Notes on Auditing Aspects:

1. Guidance Note on Audit of Fixed Assets.
2. Guidance Note on Audit of Inventories.
3. Guidance Note on Audit of Debtors, Loans and Advances.
4. Guidance Note on Audit of Investments.
5. Guidance Note on Audit of Miscellaneous Expenditure.
6. Guidance Note on Audit of Cash and Bank Balances.
7. Guidance Note on Audit of Liabilities.
8. Guidance Note on Audit of Revenue.
9. Guidance Note on Audit of Expenses.

PAPER – 6 : AUDITING AND ASSURANCE

QUESTIONS

1. State with reasons (in brief) whether the following statements are ***True*** or ***False***.

   (i) It is auditor's responsibility to maintain an adequate accounting system incorporating various internal controls.

   (ii) The risk of not detecting error is more than the risk of not detecting fraud.

   (iii) Basically, an auditor reports on the truth or otherwise of the financial statements; prevention and detection of frauds and errors are secondary to this.

   (iv) Fraud means misappropriation of goods or cash and artificial manipulation of accounts.

   (v) In case of audit of partnership or sole proprietorship, the auditor's duties are defined purely by the contract between him and the client.

   (vi) The auditor may, in planning the audit work, intentionally see the cut-off level for verifying individual transactions at a lower level than in intended to be used to evaluate the results of the audit.

   (vii) If the directors are of the opinion that any fixed asset does not have a realisable value at least equal to its book value, the fact should be stated in the accounts.

   (viii) Interest accrued but not due on "Investments" is required to be shown under appropriate sub-heads under the head "Investments".

   (ix) An auditor holds office till the due date of the next annual general meeting as determined by Sections 166 and 210 of the Companies Act, 1956.

   (x) In extreme cases, such as situations involving multiple uncertainties that are significant to the financial statements, the auditor should express a disclaimer of opinion.

   (xi) A company may maintain its books of accounts according to either mercantile system of accounting or cash system of accounting but not mixed system.

   (xii) An employee of the company cannot be appointed as auditor of its branch under section 228.

2. As an auditor, comment on the following situations/statements:

   (a) In case the existing auditors reappointed at the Annual General Meeting refused to accept the appointment, whether the Board of Directors could fill up the vacancy?

   (b) At the AGM of a company, in which a Nationalised Bank held 25% of the subscribed capital, Krishna & Co., Chartered Accountants, were appointed as auditor by passing an ordinary resolution.

   (c) The members of C Ltd. preferred a complaint against the auditor stating that he has failed to send the auditors report to them.

(d) One of the directors of Hitech Ltd. is attracted by the disqualification under Section 274(1)(g).

3. 'In vouching payments, the auditor does not merely check proof that money has been paid away.' Discuss.

4. As an auditor, what would you do in the following situations ?

   One customer from whom Rs.4 lakhs are recoverable for credit sales gives a motor car in full settlement of the dues. The directors estimate that the market value of the motor car transferred is Rs.4.20 lakhs. As on the date of the balance sheet the car has not been registered in the name of the auditee.

5. (a) Reena Ltd received Rs.50 lakhs as grant from the State Government towards the part cost of a specific machinery. The company credited the above sum of Rs.50 lakhs as income in its profit and loss account for the year. What are your views on the accounting treatment of the above receipt of Rs.50 lakhs?

   (b) As an Auditor, comment on the following situation/statement:

   JKT Ltd. having Rs.40 lacs paid up capital, Rs.9.50 lacs reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being Rs.4.90 crores, Rs.4.50 crores and Rs.6 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory.

6. State with reasons your views on the following:

   (a) Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2002-2003. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd.

   (b) Mr. Ramadas, a fellow member of the Institute of Chartered Accountants of India, working as Manager of Sivram & Co., a Chartered Accountant firm, signed the audit report of Om Ltd. on behalf of Sivram & Co.

7. How will you, as an auditor, verify and value the following ?

   (a) Preliminary expenses

   (b) Discount on issue of shares or debentures

   (c) Contingent assets

   (d) Liabilities

8. Write short notes on the following:

   (i) Auditing around the computer

   (ii) Auditing through the computer

9. Comment on the following:

   (i) While finalising an audit you have to decide whether it is necessary to disclose receivables written off or advances written back as a separate item in the financial statements. How will you proceed?

(ii) Materials have been issued on loan to other companies or contractors. Should such materials be disclosed under inventories or under the head 'loans and advances'?

(iii) A company has disclosed the figures for raw materials consumption required to be disclosed in the notes to the profit and loss statement vide Schedule VI to the Companies Act on working back or derived basis, i.e., by deducting closing stock from the sum of opening stock and purchases.

(iv) A company has included shortages, losses and wastage in the figures for raw materials consumption required to be disclosed in the notes to the profit and loss statement vide Schedule VI to the Companies Act.

10. Give your comments on "M/s Health Zone, a partnership firm, running a nursing home have decided to discontinue you as an auditor for the next year and requests you to handover all the relevant working papers of the previous year.

11. You are the auditor of a manufacturing company, whose year ends on 31st March. An event occurred after the year ended, but before you complete the audit. The audit report issued by you is dated 20th July, 2009. The sales ledger balance at 31st March, 2009 was Rs.90,000. By 20th July 2009 Rs.55,000 only had been received against this amount as full and final payment.

12. An auditor intends to use a Generalised Audit Software (GAS) application for creditors. Explain with the help of an example, the steps the auditors should take in this regard.

13. The management of Anita Limited suggested for quick completion of the statutory audit that it would give its representation about the receivables in terms of their recoverability. The management also acknowledged to the auditors that the management would give their representation after scrutinizing all accounts diligently and they own responsibility for any errors in these respects. It wanted auditors to complete the audit checking all other important areas except receivables. The auditor certified the account clearly indicating in his report the fact of reliance he placed on representation of the management.

14. How the work of an expert should be evaluated before accepted the same as an Audit evidence ?

15. (a) How does an auditor audit Government Expenditure?

    (b) What categories of Companies are specifically exempted from the application of Companies (Auditor's Report) Order, 2003?

16. (a) Give your comment on "The Central Government has appointed Mr. Sushil, a retired Finance Director of a reputed company, a non-practising member of ICAI, as a special *auditor of MM Ltd., on the ground that the company was not being managed on sound business principles. Mr. Ajay, MD of MM Ltd. feels, that the appointment of Mr. Sushil is not valid as he does not hold a certificate of practice".*

(b) As a company auditor how would you react to the following situation? Rs. 5 lakhs paid by a pharma company to the legal advisor defending the patent of a product treated as capital expenditure.

17. Mention the special steps involved in the audit of an Educational Institution.

18 Mention the special points in the case of an audit of the entity from Incomplete Records.

19. Mention any eight special points which you as an auditor would look into while auditing the books of a partnership firm.

20. Comment on the "Responsibility for properly determining the quantity and value of inventories rests with the management of the entity".

SUGGESTED ANSWERS/HINTS

1. (i) **False:** As per SA 200, it is management's responsibility and not auditor's responsibility.

   (ii) **False:** Fraud is more difficult to detect than error. This is because fraud generally involves sophisticated and carefully organized schemes to conceal it such as Forgery, Deliberate failure to record transaction, International misrepresentations to the auditor.

   (iii) **False:** The main objects of any audit are: (a) To certify the correctness of the financial position as shown in the balance sheet and the accompanying revenue statements, (b) detection of errors, (c) detection of fraud. [*STPAM's case, (2008) 170 Taxman 371 (Bom.); Frankston and Hastings Corporation v. Cohen (1960) 102 CLR 607*].

   (iv) **True:** From the auditor's point of view, fraud means misappropriation of goods or cash and artificial manipulation of accounts. (SA 240)

   (v) **True:** No basic legal requirement for audit. So, auditor's duties and rights are a matter of contract.

   (vi) **True:** This may be done to cover a large number of items and thereby reduce the likelihood of undiscovered frauds, errors. It would provide the auditor with the margin of safety when evaluating the effect of misstatements discovered during the audit.

   (vii) **False:** This requirement of Part I Schedule VI to the Companies Act, 1956 applies to Current Assets, Loans and Advances and not to Fixed Assets.

   (viii) **False:** Interest accrued on "Investments" (whether due or not) should be shown under the head "current Assets, Loans and Advances" under the sub-head "Current Assets" as the very first item "Interest accrued on investments".

   (ix) **False:** He (auditor) holds office until the conclusion of the next AGM Section 224(1).

(x) **False:** As per SA 700, the auditor should consider expressing a disclaimer of opinion (and if he believes it is necessary in circumstances, he should express a disclaimer of opinion).

(xi) **False:** A company may maintain its books of account according to the double entry system of accounting [Section 209(3)].

(xii) **True:** An employee of the company cannot be appointed as auditor of its branch under Section 228.

2. (a) Refusal by Auditors to Accept the Reappointment: Section 224(3) of the Companies Act, 1956 empowers the Central Government to fill a vacancy in case no auditors are appointed or reappointed at an annual general meeting. Since the appointment of an auditor is complete only on the acceptance of the office by the auditor, it can be deemed that in case an auditor refuses to accept the appointment then in that case no auditor has been appointed and the Central Government may appoint a person to fill the vacancy as provided in Section 224(3). Thus, the non-acceptance of appointment by the auditor does not result in any casual vacancy. Moreover, even if the auditor is existing one would not make any difference since the appointment has to be made at each AGM and the auditor must accept the same. As a general principle, the shareholders have to exercise this power in all cases, except in the case of filling a casual vacancy or appointing the first auditors. Thus, the Board of Directors are not authorised to fill up the vacancy in case the existing auditors appointed at the AGM refuse to accept the appointment.

(b) **Appointment of Auditor by Passing an Ordinary Resolution:** Section 224A of the Companies Act, 1956, provides that in case of a company in which not less than 25% of the subscribed share capital is held whether singly or in any combination, amongst others, by a public financial institution or government company or central or state government or nationalised bank or an insurance company carrying on general insurance business, the appointment or re-appointment of an auditor or auditors at each annual general meeting shall be made by a special resolution only. In the given case, the nationalised bank held 25% of the subscribed share capital which is equal to the prescribed limit of 25%.

In view of the above provisions, the appointment of Krishna & Co., Chartered Accountants, as auditor of the company is not valid, since as per law, special resolution is required in such circumstances. In such cases, it shall be deemed that no auditor has been appointed and thereupon the Central Government's power to appoint the auditor pursuant to Section 224(3) will become operative.

(c) **Dispatch of Auditor's Report to Shareholders:** Section 227 of the Companies Act, 1956 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. In Re Allen Graig and Company (London) Ltd., 1934 it was held that duty of the auditor after having signed the report to be annexed to a balance sheet is confirmed only to forwarding his report to the secretary of the company. It will be for the secretary or the director to convene a general meeting and send the balance sheet and report to the members (or other person) entitled to receive it. Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.

(d) Disqualification of a Director u/s 274(1)(g) of the Companies Act, 1956: Section 227(3)(f) as inserted by the Companies (Amendment) Act, 2000 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as directors under Section 274(1)(g) of the Companies Act, 1956. To this end, the auditor has to ensure that written representation have been obtained by the Board from each director that one is not hit by Section 274(1)(g). Since in this case, one of the director is attracted by disqualification u/s 274(g) of the Act, the auditor shall state in his report u/s 227 about the disqualification of the particular director.

3. Vouching is a substantive audit procedure which aims at verifying the genuineness and validity of a transaction contained in the accounting records. It involves examination of documentary evidence to support the genuineness of transaction. Thus the object of vouching the payments of a business is not merely to ascertain that money has been paid away; but the auditor aims to obtain reasonable assurance in respect of following assertions in regard to transactions recorded in the books of account that –

(i) a transaction is recorded in the proper account and revenue or expense is properly allocated to the accounting period;

(ii) a transaction pertains to entity and took place during the relevant period;

(iii) all transactions which have actually occurred have been recorded;

(iv) all transactions were properly authorised; and

(v) transactions have been classified and disclosed in accordance with recognised accounting policies and practices.

Thus, it is through vouching that the auditor comes to know the genuineness of transactions recorded in the client's books of account wherefrom the financial statements are drawn up.

Apart from genuineness, vouching also helps the auditor to know the regularity and validity of the transaction in the context of the client's business, nature of the organisation and organisational rules.

Thus, the auditor's basic duty is to examine the accounts, not merely to see its arithmetical accuracy but also to see its substantial accuracy and then to make a report thereon.

This substantial accuracy of the accounts and emerging financial statements can be known principally by examination of vouchers which are the primary documents relating to the transactions. If the primary document is wrong or irregular, the whole accounting statement would, in turn, become wrong and irregular. Precisely auditor's role is to see whether or not the financial statements are wrong or irregular, and for this, vouching is simply imperative. Thus, vouching which has traditionally been the backbone of auditing does not merely involve checking arithmetical accuracy but goes much beyond and aims to check the genuineness as well as validity of transactions contained in accounting records

4. As per AS 10

I. When a fixed asset acquired in exchange for another asset:

(i) Its cost is (usually) determined by reference to the fair market value of the consideration given.

(ii) It may be appropriate to consider also the fair market value of the asset acquired if this is more evident.

II. An alternative accounting treatment which is used is that:

When assets exchange are similar to record the assets acquired at net book value of the asset given up. In each case, an adjustment is made for any balancing receipt or payment of cash or other consideration.

In the given case, the company has acquired a motor car by exchange of an amount due from him.

Determination of ownership

(i) Proof of payment of consideration by the customer

(ii) Possession of assets by him is sufficient to determine ownership of the car.

Registration is only a permission given to the vehicle under the Motor Vehicles Act to ply on the road and it does not determine the ownership.

Valuation of car

(i) It will be valued at 4,00,000 because the value of asset given up is more clearly evident than the fair market value of the asset acquired.

(ii) Hence, it should be valued at Rs.4,00,000 and the asset account should be debited at Rs.4,00,000 and the customer account credited at Rs.4,00,000.

(iii) In case, the directors revalue the asset at Rs.4,20,000 then the excess of Rs.20,000 shall be treated as Revaluation revenue.

5. (a) AS 12: Accounting for government grants regards two methods of presentation of grants related to specific fixed assets in financial statements as acceptable alternatives:

(i) Under first alternative, the grant is shown in the Balance Sheet as a deduction from the gross value of a machinery. The grant is recognized in P& L A/c over the useful life of a depreciable asset by way of a reduced depreciation charges.

(ii) Under second alternative, it can be treated as deferred income which should be recognized in P & L A/c over useful life of asset in proportion in which depreciation on machinery will be charged. The deferred income pending its apportionment to P & L A/c should be disclosed in Balance Sheet with a suitable description e.g. Deferred Government Grants.

In the given case, Reena Ltd. received Rs.50 lakhs as grant towards part cost of specific machinery. The company has credited the said sum as income in its Profit and Loss account which is incorrect. As the treatment is not in accordance with Accounting Standard so company is advised to rectify as per provision given above.

(b) Internal Audit System and CARO, 2003: As per Para 4(vii) of CARO, 2003, statutory auditor is required to comment on whether the auditee company has an internal audit system commensurate with its size and nature of its business.

The clause has a mandatory application in respect of listed companies. For other companies, it is applicable if either of the following conditions is satisfied:

a. The company has a paid-up capital and reserves exceeding Rs.50 lakhs at the commencement of the financial year, or

b. The company has an average annual turnover of Rs.5 crores or more for a period of 3 years preceding the current financial year.

In the instant case, the second condition has been fulfilled by JKT Ltd. Hence, the auditor will have to mention in his report the fact of not having such internal audit in his report by the Company.

6. (a) Auditor holding securities of a company : As per sub-section (3)(e) of Section 226, a person holding any security of the company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000 w.e.f. December 13, 2001 is not qualified for appointment as auditor of that company. For the purpose of this section, "security" means an instrument which carries voting rights.

It is further laid down in sub-section (4) of Section 226 that a person is not eligible for appointment as auditor of any company, if he is disqualified from acting as auditor of that company's subsidiary or holding company or of any other subsidiary of the same holding company. Sub-section (5) of Section 226 provides that if an auditor, after his appointment, becomes subject to any of the disqualification specified in sub-sections (3) and (4), he shall be deemed to have automatically vacated his office.

A firm would also be disqualified to be appointed as an auditor even when one partner is disqualified under clause (e) of sub-section (3) of Section 226.

In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. As such, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., even when one partner is disqualified under this clause.

(b) Signature on Audit Report: Section 229 of the Companies Act, 1956 requires that only a person appointed as the auditor of the company or where a firm is so appointed, a partner in the firm practising in India, may sign the auditor's report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor. Therefore, Mr. Ramdas, a fellow member of the Institute and a manager of M/s Sivram & Co., Chartered Accountants, cannot sign on behalf of the firm in view of the specific requirements of the Companies Act, 1956. If any auditor's report or any document of the company is signed or authenticated otherwise than in conformity with the requirements of Section 229, the auditor concerned and the person, if any, other than the auditor who signs the report or signs or authenticates the document shall, if the default is willful, be punishable with a fine.

7. (a) *Preliminary expenses*: The expenses incurred for the formation and commencement of a company is usually grouped under the heading "preliminary expenses". These include stamp duties, registration fees, legal costs, cost of printing etc.

In order to verify preliminary expenses, the auditor should take into consideration the following matters:

(i) It should be seen by the auditor that no expenses other than those related to the formation of a company are included under this head.

(ii) The auditor should examine the contracts relating to preliminary expenses. If preliminary expenses that were incurred by the promoters have been reimbursed to them by the company, the resolution of the board and the power in the articles to make such payment should be considered.

(iii) The auditor can cross check the amount of preliminary expenses with that disclosed in the prospectus, statutory report and the balance sheet.

(iv) Being a fictitious asset, it should be written off as early as possible and the auditor should verify that the balance of preliminary expenses which has not been written off is shown in the balance sheet under the heading "miscellaneous expenditure".

(v) Underwriting commission and brokerage in shares and debentures should not be included under the head "preliminary expenses". The auditor should also confirm this aspect.

(vi) The bills and statements supporting each item of preliminary expenses should be checked.

(vii) The auditor should also ensure that proper deduction has been availed against taxable income under the Income Tax Act, 1961.

(b) *Discount on Issue of Shares or Debentures*: This refers to the expenditure or losses essentially of a revenue nature, which instead of being charged off as and when incurred, is accumulated in an account and the balance in the account is written off over a period of years during which its benefit is expected to accrue to the business.

In order to verify the discount on issue of shares or debentures, the auditor should pay attention to the following matters:

(i) The auditor should confirm that it continues to appear as an asset on the right side of the balance sheet as along as the discount is not written off.

(ii) If during the year, any amount has been added thereto, the auditor should ask for the justification of the same.

(iii) Being a fictitious asset, it should be written off as early as possible. The auditor should also confirm this aspect.

(iv) The auditor should see that the discount on issue of shares or debentures has been shown separately under the heading 'Discount on Issue of Shares or Debentures'.

(v) In issuing shares or debentures at a discount, whether the governing provisions relating to issue of shares and debentures have been duly complied with or not should also be checked by the auditor.

(c) *Contingent Assets*: The contingent assets are those which may arise on the happening of an uncertain event. As a general practice, contingent assets are not recorded in the balance sheet because that would imply taking credit for revenue which has not accrued. But it is logical as the contingent liabilities are shown in the balance sheet the contingent assets should also be shown. The Companies Act does not require disclosure of contingent assets in the balance sheet. However, if contingent asset have a significant value, it may be advisable to disclose such assets in a note to the balance sheet.

As regards valuation of contingent assets, it may be noted that ordinarily no valuation would be required. However, if such assets were disclosed by way of a note, a proper valuation based on the related contract would be made. Where full realization of such assets is doubtful even on the face of contingency occurring, it would be safer to value the assets on a realisable basis.

(d) *Liabilities*: The verification of liabilities is of equal importance as that of an asset. The auditor has to satisfy himself that all liabilities whether existing or contingent have been properly determined and disclosed in the balance sheet. In case liabilities are overstated or understated, the balance sheet will not represent a fair view of the state of affairs of the company. Therefore, the auditor should ensure the following:

- That liabilities shown in the balance sheet are actually payable
- That all liabilities are properly recorded in the books

- That the recorded liabilities are payable for the legitimate operations of the business, and
- That the nature and extent contingent liabilities have been disclosed in the balance sheet by way of a footnote.

For the purpose of applying verification technique, we may divide the liabilities into the following three categories:

- Fixed or long term liabilities, viz. share capital, debenture, long term loan from bank and other financial institutions etc.
- Current liabilities, viz. sundry creditors, bills payable, bank overdraft etc.
- Contingent liabilities viz. disputed liability of income tax suits pending for damages etc.

8. (i) **Audit Around the Computer:** Audit around the computer involves forming of an audit opinion wherein the existence of computer is not taken into account. Rather the principle of conventional audit like examination of internal controls and substantive testing is done. The auditor views the computer as a black box, as the application system processing is not examined directly. The main advantage of auditing around the computer is its simplicity. Audit around the computer is applicable in the following situations:

(i) The system is simple and uses generalised software that is well tested and widely used.

(ii) Processing mainly consists of sorting the input data and updating the master file in sequence.

(iii) Audit trail is clear. Detailed reports are prepared at key processing points within the system.

(iv) Control over input transactions can be maintained through normal methods, i.e. separation of duties, and management supervision.

Generalised software packages, like payroll and provident fund package, accounts receivable and payable package, etc. are available, developed by software vendors. Though the auditor may decide not to go in details of the processing aspects, if there are well tested widely used packages provided by a reputed vendor. However, he has to ensure that there are adequate controls to prevent unauthorised modifications of the package. However, it may be noted that all such generalised packages do not make the system amenable to audit. Some software packages provide generalised functions, that still must be selected and combined to achieve the required application system. In such a case, instead of simply examining the systems input and output, the auditor must check the system in depth to satisfy himself about such system. The main disadvantages of the system of auditing around the computer are:

(a) It is not beneficial for complex systems of large scale in very large multi unit, multi locational companies, having various inter unit transactions. It can be used only in case of small organisations having simple operations.

(b) It is difficult for the auditor to assess the degradation in the system in case of change in environment, and whether the system can cope with a changed environment.

(ii) **Auditing through the Computer:** This approach involves actual use of computer for processing the information by auditor. The circumstances, where auditing through the computer is done are as follows:

(i) The organisation has developed either in house or through a reputed vendor, a software package suitable to its requirement, because of inability of a generalised package to cater to the complex nature of transactions.

(ii) The system processes very large volumes of output. This makes examination of validity of input and output difficult.

(iii) The major part of the internal control system in the organisation is in the computer system itself, as the majority of the records is processed through the computer. Examples are system in bank, insurance companies, online booking in case of Railway, etc.

(iv) The logic of the system is quite complex, and there is virtually no visible audit trail. The auditor has to use the computer to test the logic and controls existing within the system.

The auditor has to use the computer system itself for verification, for which he has to be sufficiently computer literate, and should have adequate technical knowledge and expertise. The auditor can through the computer, increase his performance, and can rely on the data processing by carrying out the required tests and applying his skill.

9. (i) Receivable written of is an item of expenditure and needs to be disclosed separately as per schedule VI, if the amount exceeds Rs.5,000 or 1 per cent of the total revenue. Advances written back is an item of income and needs to be disclosed separately if it is considered material in terms of Accounting Standard - 1 (Disclosure of Accounting Polices). [Refer expert advisory opinion by ICAI].

(ii) Material given on loan cannot be classified as inventories because they do not fulfil the requirements of the definition of inventory under Accounting Standard - 2. Further, loan can be either in cash or in kind. In view of this, the materials given as loans should be classified under the head loans and advances. [Refer expert advisory opinion by ICAI].

(iii) In view of the specific requirement of Schedule VI for disclosure of actual consumption, the company is required to maintain actual issue records of raw materials and not work back or derive the consumption figures arithmetically. [Refer Statement on the Amendments to Schedule VI to the Companies Act, 1956 by the ICAI].

(iv) A company can include normal shortages, losses and wastages (but should exclude abnormal shortages, losses and wastage) in the figures for raw materials consumption required to be disclosed in the Notes to the profit and loss Statement vide Schedule VI to the Companies Act. [Refer Statement on the Amendments to Schedule VI to the Companies Act, 1956 by the ICAI].

10. As per SA 230 the working papers are the property of the auditor and the auditor has right to retain them. He may at him discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.

Working papers are the important records of the auditor. They serve as evidence of the auditor's exercise of due care and conclusion reached regarding significant matters. The client does not have a right to access the working papers and it is up to the discretion of the auditor to make them available or not to others including the client.

Hence, in the instant case, management of M/s Health Zone can't insist upon the auditor to handover the working papers of the previous year.

11. Consideration of subsequent events

SA 560 requires that the auditors should consider the effect of subsequent events on the financial statements and the auditor's report. Depending on the nature of subsequent event, i.e. adjusting event or non-adjusting event, the auditor has to examine the impact on financial statements. AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" also classifies an adjusting event which provides further evidence of conditions that existed at the balance sheet date after balance sheet date, the effect of such events have to be seen by the auditor on figures contained in the financial statements. The facts indicated in the question clearly reveal that subsequent realisation has been good. Such consideration helps the auditor in assuring the existence of debtors as also the realisability aspect. The auditor's duties in respect of debtors remaining uncollected at the time of giving audit report involves examination of actual past experience of collections from debtors. Further, the auditor has to see that how much provision was assessed in respect of bad and doubtful debts having regard to recovery position, due date, legal cases, cheques dishonoured, etc., as on March 31, 2009. Accordingly, the auditor would have now to see that in respect of outstanding amount of Rs.35,000, whether the amount of provision needs any revision.

12. The steps taken by an auditor using a GAS application for creditors are as follows:

(a) The objectives of application:

- Test the mathematical accuracy of the creditors database.
- Select for confirmation all creditors account with balances greater than Rs.10,000 plus a random sample of 50 accounts with balances less than Rs.10,000.
- Print out the confirmation and monthly statement for all selected accounts.

(b) Design the application:

- Identify the data structures used in the database.
- Specify the format for the confirmation.

(c) Code the instruction for the application:

- Enter the code directly into the GAS for the confirmation application.

(d) Process the application:

- Access the client's creditors' database with the GAS. Generally, a work file is extracted from the database for processing on the GAS.

(e) Evaluate the results of the application:

- Verify the output that tested the mathematical accuracy of the creditors' database.
- Review the confirmations and monthly statements.
- Mail confirmations and monthly statements to creditors.

13. The management of Anita Limited wants the auditor to carry out audit on all areas, except on area of receivables. There cannot be any restriction on scope of audit in case of statutory audit.

    The management representation, according to SA 580, cannot substitute other audit evidence that *the auditor could reasonably expect to be available* to the auditor.

    The audit evidence for checking receivables – say, invoices, debt acknowledgement documents, receipts, statement of accounts, confirmations etc., are available evidences which auditor is duty bound to verify.

    Just because management had owned responsibility for the correctness of its evaluation of receivables, the auditor cannot shirk his responsibility. This is negligence on his part if he relies on the management representation without assessing the corroborative available evidences.

14. An expert is a person, firm or other association of persons possessing special skill, knowledge and experience in a particular field other than accounting and auditing.

    When the auditor intends to use the work of an expert, he should examine evidence to gain knowledge regarding the terms of the expert's engagement and other matters such as:

    1. objectiveness and scope of expert's work
    2. a general outline as to the specific items in the expert's report
    3. confidentiality of the expert's work, including the possibility of its communication to third parties
    4. the expert's relationship with the client
    5. confidentiality of client's information used by the expert.

Evaluation of expert's work:

Appropriate audit evidence: Auditor should seek reasonable assurance that expert's work constitutes appropriate audit evidence by considering:

1. source data used
2. the assumptions and methods used and their consistency with prior period the result's of expert's work
3. the auditor should also satisfy himself that substance of the expert's findings is properly reflected in the financial information.

Date used by expert: The auditor should consider whether the expert has used appropriate source data by employing procedures like:

1. Inquiring expert to determine how he has satisfied himself the expert has used appropriate source data are sufficient, reliable and relevant.
2. Considering audit procedures on the data provided by the client to the expert to obtain reasonable assurance that data are appropriate.

Assumptions adopted by expert: The auditor should obtained an understanding of those assumptions and methods to determine that they are reasonable based on the auditor's knowledge of client's business and results of his audit procedures.

15. (a) Audit of Government Expenditure

Audit of expenditure of government organization or department is conducted by the Comptroller and Auditor General (C & AG) of India. It is a major constituent of the government audit. The basic standards established for expenditure audit are to confirm that there is provision for funds authorised by the competent authority setting the limits within which expenditure can be incurred. These standards are as follows:

(1) The expenditure incurred comply with the relevant provisions of the law and according to the Financial Rules and Regulation constructed by the competent authority. Such audit is known as audit against rules and orders.

(2) There is either special or general sanction allowed by the competent authority authorising the expenditure. Such an audit is known as audit of sanctions.

(3) There is provision for funds out of which expenditure is incurred and also it is authorized by the competent authority. Such audit is known as audit against provision for funds.

(4) The expenditure has been incurred with due regards to the broad and general principles of the financial propriety. Such audit is known as audit against propriety audit.

(5) Various programmes scheme and project in which huge financial expenditures have been incurred or being run economically and are yielding results expected from them. Such audit is known as performance audit.

The propriety audit and performance audit suggest completely, a different approach, adopted by the C & AG as against the regulatory audit. In the propriety audit the C & AG brings out the cases of avoidable, improper or unfruitful expenditure even though the expenditure has been incurred in compliance with the existing rules and regulations.

Performance audit goes even a step ahead and has a quite comprehensive approach as it includes 3 Es i.e. efficiency, economy and effectiveness.

(b) Application of CARO, 2003: The Companies (Auditor's Report) Order, 2003 is applicable to all types of companies but it provides that it shall not apply to:

(i) a banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949;

(ii) an insurance company as defined in clause (21) of Section 2 of the Companies Act, 1956;

(iii) a company licensed to operate under Section 25 of the Companies Act, 1956; and

(iv) a private limited company with a paid-up capital and reserves of not more than rupees fifty lakhs and which does not have outstanding loan exceeding rupees twenty five lakhs from any bank or financial institution and does not have a turnover exceeding rupees five crores at any point of time during the financial year. Thus, a private limited company, in order to be exempted from the applicability of the order, must satisfy all the conditions cumulatively.

16. (a) Appointment of Special Auditor: Section 233A of the Companies Act, 1956, under the circumstances as specified in the section, empowers the Central Government that it may issue directions to the effect that a special audit of the company's accounts for the specified period shall be conducted.

Amongst others, one of the circumstances specified is in case a company is not being managed in accordance with some business principles or prudent commercial practices. Further the said section also provides that for the purpose, it may appoint a chartered accountant, whether or not the chartered accountant is in practice, or the company's auditor itself to conduct such special audit.

Therefore, the appointment of Mr. Sushil, a non-practising member of Institute of Chartered Accountants of India is within the provisions of law and, accordingly, the contention of Mr. Ajay M.D. is not correct.

(b) Expenditure made by a pharma company to the legal advisor

Expenses of Rs. 5 lakhs made by a pharma company to the legal advisor are legal expenses. Such expenses are incurred for defending the patent of a product of the pharma company is a revenue expenditure relating to the asset because it neither enhance the capacity of the asset nor any endurable benefit is obtained in future in addition to what is available at present. The legal fees paid is normally an expenditure in the revenue nature irrespective of the amount unless it is incurred for bringing any new assets in existence. Therefore, it is not correct to treat the expenditure as capital expenditure. It would result tin the overstatement of assets value and profit and calls for qualification in the audit report.

17. The special steps involved in the audit of an educational institution are the following:

(i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

(ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.

(iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

(v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

(vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.

(vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed rules.

(viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.

(ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

(x) Verify rental income from landed property with the rent rolls, etc.

(xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

(xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.

(xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.

(xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

(xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

(xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.

(xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.

(xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.

(xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

(xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.

(xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.

(xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.

(xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

18. The examination of records and documents is one of the most important techniques through which an auditor collects evidence. Therefore, in case the records and documents maintained by an enterprise are incomplete, it would prove to be a great handicap to the auditor.

An auditor may face the situation of incomplete records under the following circumstances:

(i) Where records are kept on single entry basis; or

(ii) Where records are kept on double entry basis, but some of the records are destroyed accidentally, or are seized by authorities, or are otherwise not available for the auditors examination due to similar reasons.

Under the second circumstance, an ideal approach for carrying out audit would be that the auditor may direct the management of the enterprise to complete or reconstruct the accounting records, e.g., if vouchers are available but the cash book, journal and the ledger are not maintained, then the cash book, journal and ledger should be written up. However, if vouchers are also not available, then cash book/journal/ledger will have to be prepared by correlating the evidence available, e.g., memoranda records, bank statements, statements from outside parties, etc. Even though such books which are prepared may not be complete, but may still contain useful information for the auditor.

On the other hand, when books are maintained on single entry basis, then the management of the enterprise would be asked to write up the books, to the extent possible, as they would have been written up under double entry system.

In any case, the following steps would be required to conduct an audit:

(i) Ascertain that the balance sheet or statement of affairs as at the beginning of the year should be prepared and all the relevant accounts should be opened in the ledger. Normally, under the single entry system, cash, bank, and personal accounts are maintained.

(ii) Confirming that all entries on receipt side of the cash book are posted in the ledger, even by opening new account(s) wherever necessary.

(iii) Check that all entries on the payment side of cash book are posted in the ledger.

(iv) Confirming that all entries appearing in bank account are posted in the ledger.

(v) Analyse personal accounts of debtors. This will provide vital information regarding credit sales, sales returns, discounts allowed, bills received, bills dishonoured, etc. It would be necessary to post such items to relevant accounts, to complete the double entry from the debtors accounts.

Similarly, it would be necessary to analyse the creditors' accounts and post entries relating to credit purchase made, discounts earned, purchases returns, bills payable issued to suppliers, bills payable dishonoured, etc., to relevant accounts.

From an auditor's view point, the supervisory controls exercised by the owners are generally less reliable and hence while auditing incomplete records, auditor will largely depend on extensive substantive procedures and obtain external evidence, physical examination/ observation, management representation and perform analytical procedures.

19. Special Points in Audit of a Partnership Firm: Matters which should be specially considered in the audit of accounts of a partnership firm are as under:

(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) Examine the partnership deed signed by all partners and its registration with the registrar of firms. Also ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.

(iii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters which are not of a routine nature.

(iv) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(v) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(vi) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreement.

(vii) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners. Also see various requirements of legislations applicable to the partnership firm like Section 44(AB) of the Income-tax Act, 1961 have been complied with.

(viii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

20. The Guidance Note on Audit of Inventories specifies that the responsibility for properly determining the quantity and value of inventories rests with of the management of the entity. Therefore, it is the responsibility of the management the entity to ensure that the inventories included in the financial information are physically in existence and represent all owned by the entity.

The management can satisfy this responsibility by carrying out appropriate procedures such as verification of all items of inventory at least once in every financial year. The auditor is expected to examine the adequacy of the methods and procedures of physical verification followed by the entity. He is also required to determine whether the procedures for identifying defective, damaged, obsolete, excess and slow-moving items are well-designed and operate properly.

This responsibility of the management is not reduced even where the auditor attends any physical count of inventories in order to obtain audit evidence. The entities usually maintain detailed stock records in the form of Stores/Stock ledgers showing in respect of each major item the receipts, issues and balances. The extent of examination of these records by an auditor with reference to the relevant basic documents (e.g., goods received notes, inspection reports, material issue notes, bin cards, etc.) depends upon the facts and circumstances of each case. In valuation aspects, compliance with AS 2 should also be ensured.

QUESTIONS

1. State with reasons (in brief) whether the following statements are **True** or **False**.

   (i) Fraud means misappropriation of goods or cash and artificial manipulation of accounts by the management.

   (ii) Disclosure of accounting assumptions is essential.

   (iii) Non-Governmental Organisations are incorporated as Public sector Undertakings.

   (iv) Stores and spare parts should be shown under Fixed Assets in the Balance Sheet as per Schedule VI to the Companies Act, 1956.

   (v) Internal auditor of the company cannot be its cost auditor.

   (vi) An undischarged insolvent Chartered Accountant is not qualified to be appointed as a statutory auditor.

   (vii) The auditor should express qualified or adverse opinion if financial statements have not been prepared on going concern basis and adequate disclosure is also not made thereof in the financial statements.

   (viii) The auditor is responsible for maintaining the internal control system in the organisation.

   (ix) Voucher once used in audit should be destroyed to avoid risk of being used in more than one entry.

   (x) As per CARO 2003, an auditor is always required to report in case of a substantial part of fixed assets have been disposed off during the year.

Standards on Auditing and Guidance Notes

2. (i) In the light of SA 220, state the functions to be performed by an auditor while carrying out supervisory responsibilities during the audit?

   (ii) How an auditor can identify the related parties?

3. What do you understand by external confirmation? Give some examples where external confirmations can be used as audit evidence.

4. "The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such Communication.

Nature of Auditing

5. (i) State briefly the qualities of Auditors.

   (ii) What are the inherent limitations of audit?

6. "The audit of a financial statement relieves the management of its responsibilities". Comment

Basic Concepts in Auditing

7. While examining the going concern assumption of an entity, what important indications should be evaluated and examined?

8. State your views on the following:

   "Auditor's assessment of materiality may be different at the time of planning the engagement than at the time of evaluating the results of his audit procedures".

Preparation for an Audit

9. (i) What do you mean by Audit Documentation ?

   (ii) How working papers aid in auditing?

   (iii) XYZ Pvt. Ltd. Has decided to change its auditor. XYZ Pvt Ltd. requested its previous auditor to handover all of its previous years' working papers. He, however, refused to handover the working papers. Comment.

Internal Control

10. (i) Write a short note on - Independence of Internal Auditor.

    (ii) What are the inherent limitations of Internal Control System?

Vouching and **Verification of Assets and Liabilities**

11. How will you vouch/verify the following?

    (i) Remuneration paid to Directors

    (ii) Receipt of Capital subsidy

    (iii) Buildings

    (iv) Travelling expenses

12. How will you vouch and/or verify the following ?

    (i) Sale proceeds of Scrap Material.

    (ii) Trade Marks and Copyrights.

    (iii) Machinery acquired under Hire-purchase system.

    (iv) Work-in-progress.

The Company Audit – I

13. As an auditor, comment on the following situations/statements:

    (i) 'Bhim' owes Rs. 1010 to 'CIS' Ltd., of which he is an auditor. Is his appointment valid? Will it make any difference, if the advance is taken for meeting-out travelling expenses?

    (ii) A company has not provided depreciation on machinery on the plea that the machinery has been maintained in excellent condition and is as good as new.

(iii) ABC & Co. a firm of Chartered Accountants has three partners, A, B & C; A is also in whole time employment elsewhere. The firm is offered the audit of XYZ Ltd. and its twenty branches. The firm already holds audit of 40 companies including audit of one foreign company.

(iv) Keshav, a Chartered Accountant, was appointed as auditor of Y Ltd. in the Annual General Meeting of the company in September, 2009. In June, 2010 the company removed him through a resolution in the general meeting and appointed Raman as its auditor.

14. Discuss the provisions of the Companies Act, 1956 regarding the maintenance of proper books of accounts in respect of the following:

    (i) What are the items with regard to which the proper books of accounts should be maintained?

    (ii) Where should these books be maintained?

    (iii) What are the special provisions where the company has a branch?

    (iv) What are the circumstances in which proper books are not deemed to be kept?

15. You have been asked by a company to compile financial statements for the purpose of obtaining loan from a Bank. Draft a report to be given to the Management for the same.

16. Explain how following are dealt in Auditor's Report as per CARO:

    (i) Fraud

    (ii) Default in repayment of dues to a financial institution

    (iii) Guarantees for loan taken by others.

17. Board of Directors of ABC Ltd. wants to transfer an amount of Rs. 25 lacs lying in unpaid dividend account to their Profit and Loss account on the plea that it is 3 years old and no shareholder is expected to turn up and claim the same. As an auditor what will be your advice to Board of Directors of ABC Ltd.

18. (i) Can the company delegate authority to its Board of Directors to appoint auditors in Annual General Meeting?

    (ii) Can the company authorise its Board of Directors to fix the remuneration of the auditors appointed under section 224?

19. Mr. Prakash is the statutory auditor of Soya Ltd, which has branch in Punjab .The Company in general meeting decided to have the accounts of Punjab Branch audited by Mr. Quaid who was appointed without Mr. Prakash's knowledge and consent. State your comments on the above with reasons.

The Company Audit – II

20. How would an auditor vouch/verify the following?

    (i) Issue of Sweat Equity Shares.

    (ii) Alteration of share capital

21. "Interest on share capital was paid to the shareholders as the company had a long gestation period before it could become operational". Comment.

Special Audits

22. (i) What special steps will you take into consideration in auditing the receipts from entry fees of an amusement park? Mention any four point's specific to the issue.

    (ii) What special steps will you take into consideration in auditing the accounts of a hotel?

23. An audit of Expenditure is one of the major components of Government Audit. In the context of 'Government Expenditure Audit', write in brief, what do you understand by:

    (i) Audit against Rules and Orders

    (ii) Audit of Sanctions

    (iii) Audit against Provision of Funds

    (iv) Propriety Audit

    (v) Performance Audit

24. Explain in detail the duties of Comptroller and Auditor General of India.

25. You have been appointed as the auditor of a Multiplex Cinema House. Draw an audit programme in respect of its Revenue and Expenditure.

SUGGESTED ANSWERS/HINTS

1. (i) False. Fraud is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

(ii) False. If the fundamental accounting assumptions, viz., Going concern, Consistency and Accrual are followed in preparation and presentation of the financial statements ,specific disclosure is not required however if a fundamental accounting assumptions are not followed, the fact should be disclosed.

(iii) False. Non-Governmental Organisations are generally incorporated as societies under the Societies Registration Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGOs can also be incorporated as a company under section 25 of the Companies Act, 1956.

(iv) False. Normally, stores and spare parts should be shown under Current Assets in the Balance Sheet as per Schedule VI to the Companies Act, 1956 but if it is in relation to acquisition of fixed assets or construction of fixed asset it will form part of Fixed Asset.

(v) True: As per notification issued by the DCA, cost auditor should not be the internal auditor of a company for the period for which he is conducting the cost audit. This is because if the cost auditor is internal auditor, he would not be able to discharge his duties properly.

(vi) True: An undischarged insolvent Chartered Accountant is debarred from the register of members of ICAI, so he cannot continue as the member of ICAI. Thus he is not qualified to be appointed as a statutory auditor.

(vii) True. As per SA 570 "Going Concern", if financial statements have not been prepared on the going concern basis and adequate disclosure is also not made thereof in the financial statements, the auditor should express a qualified or adverse opinion, as appropriate.

(viii) False. Management is responsible for devising and maintaining the system of internal control.

(ix) False. After the examination is over, each voucher should be either impressed with a rubber stamp or initialed so that it may not be presented again in support of another entry.

(x) False. As per CARO 2003 an auditor is required to report only in case of a substantial part of fixed assets have been disposed off during the year and it has affected the going concern concept.

2. (i) As per SA 220 "Quality Control for Audit Work", an auditor has to perform the following supervisory responsibilities during the audit:

(a) The auditor is required to monitor the progress of the audit to consider whether:

(i) assistants have the necessary skills and competence to carry out their assigned tasks;

(ii) assistants understand the audit directions; and

(iii) the work is being carried out in accordance with the overall audit plan and the audit programme;

(b) The auditor should be informed of and should address significant accounting and auditing questions raised during the audit, by assessing their significance and modifying the overall audit plan and the audit programme as appropriate; and

(c) The auditor is required to resolve any differences of professional judgement between personnel and consider the level of consultation that is appropriate.

(ii) Identification of Related Parties: As per SA 550 "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. Since it is the management, which is primarily responsible for identification of related parties, SA 550 requires that to identify names of all known related parties, the auditor may carry out the following procedures:

(a) review his working papers for previous years for names of known related parties;

(b) review the entity's procedures for identification of related parties;

(c) inquire as to affiliation of directors, key management personnel and officers with other entities, etc.;

(d) review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a list of principal shareholders from the share register;

(e) review memorandum and articles of association, minutes of the meetings of shareholders and the board of directors and its committees and other relevant statutory records such as the register of directors' interests;

(f) inquire of other auditors such as internal auditor, special auditors appointed under any statute, cost auditors, and concurrent auditors of the entity as to their knowledge of additional related parties and review the report of the predecessor auditors;

(g) review the entity's income tax returns and other information supplied to regulatory agencies; and

(h) review the joint venture and other relevant agreements entered into by the entity.

In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Examples include–

- Transactions which have abnormal terms of trade, such as, unusual prices, interest rates, guarantees, and repayment terms.
- Transactions which lack an apparent logical business reason for their occurrence.
- Transactions in which substance differs from form.
- Transactions processed in an unusual manner.
- High volume or significant transactions with certain customers or suppliers as compared with others.
- Rendition of services without receipt or provision of management services at no charge.

Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identifications of related parties.

3. According to **SA 505 "External Confirmations",** external confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements. In other words, we can say the process of external confirmation consist of:

- Selecting the items for which confirmations are needed.
- Designing the form of the confirmation request.
- Communicating the confirmation request to the appropriate third party.
- Obtaining response from the third party.
- Evaluating the information or absence thereof.

Examples of the situations where external confirmations can be used as audit evidence are:

(a) Bank balance from bankers

(b) Account receivable balances

(c) Stocks held by third parties

(d) Property title deeds held by third parties

(e) Investments purchased but delivery not taken

(f) Loan from lenders

(g) Account payable balances

(h) Long outstanding share application money.

4. Communications of audit matters with those charged with governance

SA 260 deals with communications of audit matters with those charged with governance. The following are the audit matters of governance interest which are to be communicated.

(a) The general approach and overall scope of the audit, including any expected limitations thereon, or any additional requirements;

(b) The selection of or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements;

(c) The potential effect on the financial statements of any significant risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements;

(d) Adjustments to financial statements arising out of audit that have, or could have, a significant effect on the entity's financial statements;

(e) Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern;

(f) Disagreements with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or the auditor's report. These communications include consideration of whether the matter has, or has not, been resolved and the significance of the matter;

(g) Expected modifications to the auditor's report;

(h) Other matters warranting attention by those charged with governance, such as material weaknesses in internal control, questions regarding management integrity, and fraud involving management;

(i) Any other matters agreed upon in the terms of the audit engagement.

5. (i) The person conducting audit is known as the auditor; he makes a report to the person appointing him after due examination of the accounting records and the accounting statement in the form of an opinion on the financial statements. The opinion that he is called upon to express is whether the financial statement reflect a true and fair view.

Qualities of Auditors: The auditor should possess specific knowledge of accountancy, auditing, taxation, etc. which are acquired by him during the course of his theoretical education.

The auditor should also have sufficient knowledge of general principles of law of contracts, partnership; specific statutes and provisions applicable, e.g. Companies Act, 1956, Co-operative Societies Act, etc.; client's nature of business and its peculiar features. Apart from the knowledge acquired by the auditor in the formal manner, the auditor should also possess certain personal qualities such as, tact; caution; firmness; good temper; judgement; patience; clear headedness and commonsense; reliability and trust, etc. Both practical training and theoretical education are equally necessary for the development of professional competence of an auditor for undertaking any kind of audit assignment.

In short, all those personal qualities that goes to make a good person contribute to the making of a good auditor. In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence. In fact, SA 200 mentions integrity, objectivity and independence as one of the basic principles.

Auditing is a profession, calling for wide variety of knowledge to which no one has yet set a limit, the most useful part of the knowledge is probably that which cannot be learnt from books because its acquisition depends on the alertness of the mind in applying to ever varying circumstances, the fruits of his own observation and reflection; only he who is endowed with common sense in adequate measure can achieve it.

Lord Justice Lindley in the course of the judgment in the famous *London & General Bank case* had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, "an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true".

(ii) The objective of an audit of financial statements, prepared within 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 himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The process of auditing, however, is such that it suffers from certain inherent limitations, i.e., the limitation which cannot be overcome irrespective of the nature and extent of audit procedures. Such limitations arise, first of all, on account of exercise of judgment in the auditor's work in deciding the extent of audit procedures and exercising judgement also in assessing the reasonableness of the judgment and estimates made by the management in preparing the financial statements. Secondly, much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. The audit evidence obtained by an auditor is generally persuasive in nature rather than conclusive in nature. Because of these factors, the auditor can only express an opinion. Therefore, absolute certainty in auditing is rarely attainable. There is also likelihood that some material misstatements of the financial information resulting from fraud or error, if either exists, may not be detected. Another reason which may contribute to inherent limitation is the fact that the entire audit process is generally dependent upon the existence of an effective system of internal control. In such an event, it is clearly evident that there will always be some risk of an internal control system failing to operate as designed. No doubt, internal control system also suffers from certain inherent limitations since any system of internal control is ineffective against fraud involving collusion among employees or fraud committed by management. Certain levels of management may be in a position to override controls; for example, by directing subordinates to record transactions incorrectly or to conceal them, or by suppressing information relating to transactions. Such inherent limitations of internal control system also contribute to inherent limitations of an audit. Therefore, it is quite apparent from above that an audit suffers from certain inherent limitations.

6. According to SA 200A, "Objective and Scope of the Audit of Financial Statements", preparation of financial statements is the responsibility of the management of an entity. Auditor's responsibility is only to express an opinion on the financial statements based on his audit. Management's responsibilities include

- The maintenance of adequate accounting records and internal controls
- The selection and application of accounting policies and
- The safeguarding of the assets of the enterprise.

Thus, the audit of the financial statements does not relieve management of any of its responsibilities regarding preparation of financial statements. In view of the above the above statements is true.

7. **Evaluating Going Concern Assumption:** According to SA 570, "Going Concern", while planning and performing audit procedure and in evaluating the results thereof, the auditor should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements. In assessing such a risk, the auditor should examine the following indications.

Financial Indications

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

Operating Indications

- Loss of key management without replacement.
- Loss of a major market, franchise, licence, or principal supplier.
- Labour difficulties or shortages of important supplies.

Other Indications

- Non-compliance with capital or other statutory requirements.
- Pending legal proceedings against the entity that may, if successful, result in judgments that could not be met.
- Changes in legislation or government policy.
- Sickness of the entity under any statutory definition.

8. SA 320 on "Materiality in Planning and Performing an Audit" recommends that the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected

misstatements, if any, on the financial statements and in forming the opinion in the auditor's report. SA 450 "Evaluation of Misstatements Identified during the Audit" , explains how materiality is applied in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements

While formulating an overall audit plan, SA 300(Revised) on "Planning an Audit of Financial Statement" also requires the auditor to consider the setting of materiality levels for audit purpose right from the initial stages. Accordingly, the auditor has to access the materiality aspect right from the initial stages. Accordingly, the auditor has to access the materiality aspect right from the initial stages of audit planning and throughout the process of conducting the audit till the audit opinions is formulated.

However, the auditor's assessment of materiality may be different at the time of initially planning the engagement than at the time of evaluating the results of his audit procedures. Since audit materiality related to specific amount balances and classes of transactions, helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk. Such selection of audit procedures would undergo a change as audit work progress. The assessment of materiality and audit risk the stage of evaluating the results of audit procedures would also change because of a change in circumstances or a change in the auditor's knowledge as results of audit. For example, if the audit is planned prior to period end, the auditor will anticipate the results of operations and the financial position. If actual results of operations and financial position are substantially different, the assessment of materiality and audit risk may also change. Additionally the auditor may, in planning the audit work, intentionally set the acceptable cut-off level for verifying individual transactions at a lower level than is intended to be used to evaluate the results of the audit. This may be done to cover a larger number of items and thereby reduce the likelihood of undiscovered misstatements and to provide the auditor with the major of safety when evaluating the effect of misstatements discovered during the audit.

9. **(i)** As per SA 230 'Audit Documentation', the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached is known as Audit Documentation.(terms such as "working papers" or "workpapers" are also sometimes used)..

(ii) Working papers

(a) aid in the planning and performance of the audit;

(b) aid in the supervision and review of the audit work; and

(c) provide evidence of the audit work performed to support the auditor's opinion.

(iii) Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client. Auditor should adopt reasonable procedures for custody and confidentially of his working papers. Requests are sometimes received by the members of the Institute, who have/had been performing the duties as the auditors of an enterprise, to provide access to their audit working papers. The requests may be made by the clients or other auditors of the enterprise or its related enterprise such as a parent enterprise. An auditor is not required to provide the client or the other auditors of the same enterprise or its related enterprise such as a parent or a subsidiary, access to his audit working papers. The main auditors of an enterprise do not have right of access to the audit working papers of the branch auditors. In the case of a company, the statutory auditor has to consider the report of the branch auditor and has a right to seek clarifications and/or to visit the branch if he deems it necessary to do so for the performance of the duties as auditor. An auditor can rely on the work of another auditor, without having any right of access to the audit working papers of the other auditor. For this purpose, the term 'auditor' includes 'internal auditor'. As stated above, the client does not have a right to access the working papers of the auditor. However, the auditor may, at his discretion, in cases considered appropriate by him, make portions of or extracts from his working papers available to the client. Therefore XYZ Pvt. Ltd. can not force the auditor to handover his working papers.

10. (i) Independence of Internal Auditor: The concept of independence is equally relevant for internal auditor also. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. Internal auditor is part of the management but he evaluates the functioning of the management at different levels.

Therefore, to be efficient and effective, the internal auditor must have adequate independence. It may be noted that by its very nature, the internal audit function cannot be expected to have the same degree of independence as is essential when the external auditor expresses his opinion on the financial information. To ensure his independence he is made responsible directly to the Board of Directors through audit committee. Such a channel of communication provides an independent mode whereby an internal auditor can communicate and share his views on the scope of internal audit, findings, etc. If internal auditor is made subordinate to lower level, his independence will be effected which will affect his functioning and effectiveness. An outsider, like a firm of chartered accountants, if acting as internal auditor, is likely to be more independent than an employee of the organization.

(ii) Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as:-

(a) Management's consideration that cost of an internal control does not exceeds the expected benefits.

(b) Most controls do not tend to be directed at unusual transactions.

(c) The potential of human error due to carelessness, misjudgment and misunderstanding of instructions.

(d) The possibility that control may be circumvented through collusion with employees or outsiders.

(e) The possibility that a person responsible for exercising control may abuse that authority.

(f) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.

(g) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

(h) Inherent limitations of Audit.

11. (i) Remuneration paid to Directors

The following points must be considered while vouching the directors' remuneration in case of a public company and private company which is a subsidiary of a public company –

(a) *Examine the Entitlement*: The directors are not automatically entitled to remuneration. It is paid either according to the term of articles of association or in accordance with a resolution of the general meeting.

(b) *Examine Adherence to Legal Provisions*: The auditor should examine adherence to relevant sections of the Act such as –

- Section 309(3) and (4) which deals with manner of payment of managerial remuneration.
- Section 309(2) which deals with payment of fees for each meeting of the Board, or a committee thereof, attended by him.
- Section 198 which has prescribed the overall limit to managerial remuneration.
- Pat II Schedule XIII to the Act that has laid down conditions for payment of remuneration for companies having profits, those having no profits or inadequate profits and companies having negative effective capital.
- Section 310 which provides for increase in remuneration.

(ii) Receipt of Capital Subsidy

(a) 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.

(b) Examine documents for the grant of subsidy and note the conditions attached with the same relating to use of subsidy.

(c) 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.

(d) Check the relevant entries in the books for receipt of subsidy.

(e) 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.

(iii) Buildings

(a) Examine the title deeds of buildings to see whether the client holds the title on the balance sheet date. If the property has been mortgaged, the title deeds will be in the possession of the mortgagee, from whom a certificate should be obtained to that effect.

(b) Verify the original cost of buildings by reference to the deed of conveyance. If the building is constructed by the client, verify the original cost by reference to the cost as recorded in the books of account of the year in which the construction was completed.

(c) Verify that appropriate depreciation has been provided against the buildings. In case no depreciation is provided on the buildings, a note to this effect should be given in the profit and loss account.

(d) See the appropriate lease deed, if the building is leasehold, to ascertain the cost, amortisation, etc. Also ensure that all covenants in the lease deed have been fulfilled by the client.

(e) See that the buildings have been valued at cost less depreciation. If any revaluation has taken place, see the basis of revaluation and ensure that the disclosure of the same has been made. In case of a company, the requirements of Schedule VI have been complied with.

(f) See that the relevant particulars of buildings have been entered in the fixed assets record maintained by the client.

(iv) Travelling expenses

(a) It is normally payable to staff according to rules approved by directors or partners. Where no rules exist, the auditor should recommend that these be framed for controlling the expenditure. In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred. A voucher should be demanded for all items of expenses incurred, except those which are capable of independent verification.

(b) As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business and that the directors were entitled to receive the amount from the business.

(c) The voucher for travelling expenses should normally contain the name and designation of the person claiming the amount, particulars of the journey, amount of railway or air fare, amount of boarding or lodging expenses or daily allowance along with the dates and times of arrival and departure from each station and other expenses claimed, e.g., tips, conveyance, etc.

(d) If the journey was undertaken by air, the counterfoil of the air ticket should be attached to the voucher; this should be inspected. For travel by rail or road, the amount of the fare claimed should be checked from some independent source.

(e) Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified.

(f) The evidence in regard to sundry expenses claimed is generally not attached to T.A. bills. So long as the amount appears to be reasonable it is usually not questioned.

(g) All vouchers for travelling expenses should be authorised by some responsible official.

(h) In case of foreign travel or any extraordinary travel, the expenses, before being paid, should be sanctioned by the Board. The travelling advance taken, if any, should be settled on receipt of final bills. At the year, the amount not settled should be shown appropriately in the Balance Sheet.

(i) Unless the articles specifically provide or their payment has been authorised by a resolution of shareholders, directors are not entitled to charge travelling expenses for attending Board Meetings.

12. (a) Sale Proceeds of Scrap Material

(i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.

(ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.

(iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.

(iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.

(v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.

(vi) See that scrap materials sold have been billed and check the calculations on the invoices.

(vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it.

(viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

(b) Trade Marks and Copyrights

(i) Obtain schedule of Trade Marks and Copyrights duly signed by the responsible officer and scrutinise the same and confirm that all of them are shown in the Balance Sheet.

(ii) Examine the written agreement in case of assignment of Copyrights and Assignment Deed in case of transfer of trade marks. Also ensure that trade marks and copyrights have been duly registered.

(iii) Verify existence of copyright by reference to contract between the another and noting down the terms of payment of royalty.

(iv) See that the value has been determined properly and the costs incurred for the purpose of obtaining the trade marks and copyrights have been capitalised.

(v) Verify existence of copyright by reference to contact between the author and the entity and to check the payments of royalty made to author.

(vi) Ascertain that the legal life of the trade marks and copyrights have not expired.

(vii) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations.

(c) Machinery acquired under Hire-purchase system

(i) Examine the Board's Minute Book approving the purchase on hire-purchase terms.

(ii) Examine the hire-purchase agreement carefully and note the description of the machinery, cost of the machinery, hire purchase charges, terms of payment and rate of purchase.

(iii) Assets acquired under Hire Purchase System should be recorded at the full cash value with corresponding liability of the same amount. In case cash value is not readily available, it should be calculated presuming an appropriate rate of interest.

(iv) Hire purchased assets are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof. The interest payable along with each installments, whether separately or included therein should be debited to the interest account and not to the asset account.

(d) Work-in-Progress

The audit procedures regarding work-in-progress are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the work-in-progress for assessing the appropriateness of its valuation. For this purpose, the auditor may examine the production/costing records (i.e., cost sheets), hold discussions with the personnel concerned, and obtain expert opinion, where necessary. The auditor may advise his client that where possible the work-in-progress should be reduced to the minimum before the closing date. Cost sheets of work-in-progress should be verified as follows:

(i) Ascertain that the cost sheets are duly attested by the works engineer and works manager.

(ii) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost sheets by reference to the records maintained in respect thereof.

(iii) Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimated cost expected.

(iv) Ensure that the allocation of overhead expenses had been made on a rational basis.

Compare the cost sheet in detail with that of the previous year. If they vary materially, investigate the cause thereof.

13. (i) Indebtedness to the Company: As per Section 226(3) (d) of the Companies Act, 1956, a person who is indebted to the company for an amount exceeding Rs.1000/- or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding Rs.1000/- then he is not qualified for appointment as an auditor of a company. Accordingly, Bhim's appointment is not valid and he is disqualified as the amount of debt exceeds Rs.1000. Even if the advance was taken for meeting out travelling expenses particularly before commencement of audit work, his appointment is not valid because in such a case also the auditor shall be indebted to the company. The auditor is entitled to recover fees on a progressive basis only.

(ii) Non-Provision of Depreciation: The machinery is as good as new. The plea of the management of the company not to provide for depreciation on its assets in a particular year on account of the reason that the company has maintained the machinery in an excellent way during the year is not acceptable because as per the definition of depreciation given in AS 6 on "Depreciation Accounting", "depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes".

Thus, depreciation also arises due to efflux of time and, therefore, depreciation should be provided irrespective of whether the assets were maintained very well during the year. Hence, the mere fact that the assets have been maintained excellently during the year is not an acceptable ground for the management not to provide for depreciation.

(iii) Ceiling on Number of Company Audits: According to Section 224(1B) of the Companies Act, 1956 certain chartered accountants cannot hold more than the specified number of company audits. The specified number is to be computed in the following manner:

In the case of firm of chartered accountants, the specified number should be construed as twenty companies (out of which not more than ten may have a paid-up share capital of rupees twenty five lakhs or more) per such partner who is not in whole-time employment elsewhere.

In the firm of ABC & Co., A is in whole-time employment elsewhere; therefore, he will be excluded in determining the number of company audits that the firm can hold. If B and C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by ABC & Co., is forty, out of which not more than twenty companies may have a paid-up share capital of rupees twenty five lakhs or more.

Branch audits are not to be counted in computing this specified number. Therefore, it does not matter whether XYZ Ltd. is having twenty branches. Audits of the accounts of foreign companies are also not to be included within the specified number as such companies are outside the scope of section 224.

Thus, the acceptance of audit of XYZ Ltd. and its twenty branches will accordingly be within specified limits.

(iv) **Removal of an Auditor:** The removal of auditor Keshav, a chartered accountant, before the expiry of the term of an auditor's appointment by M/s Y Limited is invalid. Sub-section (7) of Section 224 of the Companies Act, 1956 provides that an auditor may be removed from office before the expiry of his term, by the company only in a general meeting after obtaining the prior approval of the Central Government in that behalf.

However, such approval is not required for the removal of the first auditor appointed by the Board of Directors under the proviso to sub-section (5) of Section 224. Since prior approval of the Central Government has not been obtained, the removal of Keshav is not valid and, therefore, Keshav continues to be the auditor. The appointment of Raman in his place is void.

14. **(i)** Section 209(1) *of the Companies Act, 1956* requires that every company shall keep proper books of account with respect to—

(a) All sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;

(b) All sales and purchases of goods by the company;

(c) The assets and liabilities of the company; and

(d) In the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of account:

(ii) Every company shall keep proper books of account at its registered office. It is however provided in section 209(1) that all or any of the books of account (above) may be kept at such other place in India as the Board of directors may decide and when the Board of directors so decides, the company shall, within seven days of the decision, file with the Registrar a notice in writing giving the full address of that other place.

(iii) Sub section (2) of Section 209 of the Companies Act, 1956 states that where a company has a branch office, whether in or outside India, the company shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns, made up to dates at intervals of not more than three months, are sent by the branch office to the company at its registered office or the other place referred to in sub-section (1) of Section 209.

(iv) Sub section (3) of Section 209 of the Companies Act, 1956 states that for the purposes of sub-sections (1) and (2) of section 209 , proper books of account shall not be deemed to be kept with respect to the matters specified therein,—

(a) if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company or branch office, as the case may be, and to explain its transactions; and

(b) if such books are not kept on accrual basis and according to the double entry system of accounting.

15. Draft Report of an Engagement to Compile Financial Statements - SRS 4410

To

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……………..

On the basis of the accounting records and other information and explanations provided to us by the management, we have compiled, the unaudited balance sheet of ………………..*(name of the entity)* as at March 31, XXXX and the related profit and loss account and the cash flow statement for the period then ended.

The management of the ________ *(name of the entity)* is responsible for:

(a) Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant.

(b) Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;

(c) Preparation and presentation of financial statements in accordance with the applicable laws and regulations, if any.

(d) Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities.

(e) Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non compliance.

The compilation engagement was carried out by us in accordance with the Standard on Related Services (SRS) 4410 , "Engagements to Compile Financial Information", issued by the Institute of Chartered Accountants of India.

The balance sheet and the profit and loss account are in agreement with the books of account. We have not audited or reviewed these financial statements and accordingly express no opinion thereon.

For ABC & Co.

Chartered Accountants

…………………………...

Signature

(Name of the accountant and membership number)

Date:

Place:

16. In the light of CARO 2003, the role of auditor is to report on the below mentioned aspects in following manner:

(i) Fraud.

The auditor should state whether any fraud on or by the company has been noticed or reported during the year, if yes, the nature and the amount involved.

(ii) Default in repayment of dues to a financial institution.

When the company has defaulted in repayment of dues to a financial institution or bank or debenture holders then the auditor has to state the period and amount of default.

(iii) Guarantees for loan taken by others.

The auditor should comment whether the company has given any guarantee for loans taken by others from banks, financial institutions, the terms and conditions of which are prejudicial to the interest of the company.

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

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

In the instant case, action of the company in transferring the amount after 3 years from unpaid dividend A/c to Profit & Loss Account is non-compliance of the section and may invite imprisonment and/or fine. The auditor should advise the board of directors of ABC Ltd., not to transfer the said amount to its Profit & Loss Account in violation of Section 205A and if the board of directors does not agree, he should qualify his report.

18. (i) The company Annual General Meeting should appoint the auditors themselves. However, it is not allowed for the AGM to delegate power to the Board of Directors for the following reasons:

(a) There are no express provisions which allows delegation { except section 228(3) (a) permits delegation of authority to the Board to appoint Branch auditors).

(b) The only situations where the Board of Directors are permitted to appoint Auditors are:

- Appointment of first auditors
- Filling up casual vacancy except when the casual vacancy caused due to resignation of auditor.

(c) The aim of the act is to ensure that members can safeguard their financial interests.

(ii) Yes. Section 224(8) (a) states that the remuneration of the auditors of a company may be fixed by the Board or the Central Government if an auditor is appointed by the Board of directors or Central Government, as the case may be.

19. As per section 228(3)(a), where a company in general meeting decides to have the accounts of a branch audited otherwise than by the company's auditor, the company in that meeting shall do either of the following two things:-

(a) appoint a person qualified for appointment as auditor of the company under section 226, or if the branch is situated outside India, a person qualified under section 226 or accountant duly qualified to be auditor under the laws of that country, or

(b) authorise the Board of directors to appoint such a person in consultation with the company's auditor.

So, it is clear that if a company itself appoints the branch auditor there is no need for consultation with the statutory auditor (as is the case in the present problem). The need for consolation with company's auditor arises only when the Board of directors appoints the branch auditor in pursuance of the meeting's authorization under section 228(3) (a). In that case, the Board of Directors should appoint the branch auditor in consultation with the company's auditor.

20. (i) Issue of Sweat Equity Shares

The Companies (Amendment) Act, 1999 recognised that in the wake of globalisation of corporate sector, the employees will have to be rewarded suitably to share in the growth of company. By insertion of section 79A, the employees may be compensated in the form of "sweat equity shares". As per explanation to section 79A, the expression "sweat equity shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. The auditor may see that the sweat equity shares issued by the company are of a class of shares already issued and following conditions are fulfilled:

(a) The issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting;

(b) The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) Not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence business;

(d) The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by the Securities Exchange Board of India in this behalf:

Provided that in the case of a company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.

For the purposes of this sub-section, the expression "a company" means the company incorporated, formed and registered under this Act and includes its subsidiary company incorporated in a country outside India.

(ii) Alteration of Share Capital

A company, having a share capital, if so authorised by its Articles, may alter its share capital by an ordinary resolution without confirmation of the Court, in any of the manners authorised by Section 94. Each alteration made should be noted in every copy of the Memorandum of Articles issued subsequent to date of the alteration (Section 40). The auditor's duties in the circumstances shall be:

(a) to verify that the alteration of capital is authorised by the Articles;

(b) to inspect the minutes of the shareholders authorising the alteration;

(c) to obtain Allotment Lists containing details of the new holdings of share or stock by each member and to verify the same with the entries.

(d) to inspect the directors' resolution in regard to allotment, consolidation, conversion or sub-division passed pursuant to the resolution of the members;

(e) to examine the cancelled share certificates, if any, and agree the same with the counterfoils of new certificates issued;

(f) to see that the procedure, prescribed by the Articles in this regard, has been complied with;

(g) to verify that the share capital account is correctly shown in the Balance Sheet; and

(h) to see that the necessary intimation to the Registrar contemplated by Section 95 has been sent.

21. Section 208 of the Companies Act, 1956 permits payment of interest to shareholders out of capital, where there is a long gestation period in the following manner:

1. Where any shares in a company are issued for the purpose of raising money to defray the expenses of the construction of any work or building, or the provision of any plant, which cannot be made profitable for a lengthy period, the company may—

   (*a*) pay interest on so much of that share capital as is for the time being paid up, for the period and subject to the conditions and restrictions mentioned in sub-sections (2) to (7); and

   (*b*) charge the sum so paid by way of interest, to capital as part of the cost of construction of the work or building, or the provision of the plant.

2. No such payment shall be made unless it is authorised by the articles or by a special resolution.

3. No such payment, whether authorised by the articles or by special resolution, shall be made without the previous sanction of the Central Government.

   The grant of such sanction shall be conclusive evidence, for the purposes of this section, that the shares of the company, in respect of which such sanction is given, have been issued for a purpose specified in this section.

4. Before sanctioning any such payment, the Central Government may, at the expense of the company, appoint a person to inquire into, and report to the Central Government on, the circumstances of the case; and may, before making the appointment, require the company to give security for the payment of the costs of the inquiry.

5. The payment of interest shall be made only for such period as may be determined by the Central Government; and that period shall in no case extend beyond the close of the half-year next after the half-year during which the work or building has been actually completed or the plant provided.

6. The rate of interest shall, in no case, exceed twelve per cent per annum or such other rate as the Central Government may, by notification in the Official Gazette, direct.

7. The payment of the interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.

8. Nothing in this section shall affect any company to which the Indian Railway Companies Act, 1895 (10 of 1895), or the Indian Tramways Act, 1902 (4 of 1902) applies.

22. (i) Audit of receipts from Entry Fees of an Amusement Park

(a) Evaluate the internal control system regarding entry and collection for entry tickets including rotation of staff.

(b) Ensure that tickets are pre numbered.

(c) Ensure that the deposit of cash collected into the bank account very same next day.

(d) Compute analytical ratios in respect of the receipts pattern i.e. on weekends, holidays, etc. and make comparisons to draw conclusions.

(ii) Audit of accounts of Hotel.

The business of running a hotel is very much dissimilar to running an industrial unit for manufacturing of products. It is a service-oriented industry. The business is characterized by handling of large amounts of liquid cash, stock of foods providing a variety of services, and keeping watch on customers to ensure that they do not leave hotel without settling the dues. In view of these, the following matters require special attention by the auditor.

1. *Internal Control:* Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:

   (a) Effectiveness of arrangement regarding receipts and disbursements of cash.

   (b) Procedure for purchase and stocking of various commodities and provisions.

   (c) Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.

   (d) System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.

   (e) Ensure that are trading accounts are prepared preferably weekly, for each sales point. A scrutiny of the percentage of profit should be made, and any deviation from the norms is to be investigated.

2. *Room Sales and Cash Collections*

   (a) There are various sales points scattered in a hotel and sales are both for cash and credit. The control over cash is very important. The charge for room sales is made from the guest register, and tests are to be carried out to ensure that the correct numbers of guests are charged for the exact period of stay. Any difference between the rate charged to the guests and standard room rent is to be investigated to see that it is properly authorized.

   (b) The total sales reported with the total bills issued at each sales point have to be reconciled.

   (c) Special care must be taken in respect of bills issued to customers who are staying in the hotel, because they may not be required to pay the bills immediately in cash but at a future date or by credit cards. Billing is to be done room-wise. It must be ensured that all customers pay their bills on leaving the hotel or within specified dates.

3. *Stock:* the stocks in a hotel are all saleable item like food and beverages. Therefore, following may be noted in this regard:

(a) All movement and transfer of stocks must be properly documented.

(b) Areas where stocks are kept must be kept locked and the key retained by the departmental manager.

(c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.

(d) Many hotels use specialized professional valuers to count and value the stocks on a continuous basis throughout the year.

(e) The auditor should ensure that all stocks are valued at the year end and that he should himself be present at the year end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories

4. *Fixed Assets:* The fixed assets should be properly depreciated, and the Fixed Assets Register should be updated.

5. *Casual Labour*: In case the hotel employs a casual labour, the auditor should consider, whether adequate records have been maintained in this respect and there is no manipulation taking place. The wages payment of the casual labour must also be checked thoroughly.

6. The compliance with all statutory provisions, and compliance with the Foreign Exchange Regulations must also be verified by the auditor, especially because hotels offer facility of conversion of foreign exchange to rupees.

7. Other special aspects are to be verified as under

(a) Consumption shown in various physical stock accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.

(b) All payments to the foreign collaborator, it any, are to be checked.

(c) Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.

(d) Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the arrangements made.

(e) In depth check should be carried out on the customers' ledgers to verify that all charges have been properly made and recovered.

(f) The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.

(g) Expenses for painting, decoration, renovation of building, etc. are to be properly checked.

(h) It is common that hotels get their bookings done through travel agents. The auditor should ensure that the money is recovered from the travel agents as per credit terms allowed. Commission paid to travel agents should be checked by reference to the agreement on that behalf.

(i) Apart from control over stock of edibles, control over issue and physical stock of linen crockery, cutlery, glassware, silver, toilet items, etc. should be verified.

(j) The auditor should verify the restaurant bills with reference to KOT (Kitchen order Ticket).

(k) The auditor should ensure that all taxes have been included in the client's bills.

(l) Computation and payment of salaries and wages vis-a-vis number of employees must be checked.

23. Government Expenditure Audit

Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:

(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 in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.

(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. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

24. Duties of C&AG: The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under:

(i) Compile and submit Accounts of Union and States - The C&AG shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account.

(ii) General Provisions Relating to Audit - It shall be the duty of the C&AG –

(a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;

(b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;

(c) to audit and report on all trading, manufacturing profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.

(iii) *Audit of Receipts and Expenditure* - Where any body or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

(iv) *Audit of Grants or Loans* - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

(v) *Audit of Receipts of Union or States* - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make this purpose such examination of the accounts as he thinks fit and report thereon.

(vi) *Audit of Accounts of Stores and Stock* - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and stock kept in any office or department of the Union or of a State.

(vii) *Audit of Government Companies and Corporations* - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 1956.

25. Audit Programme of Multiplex

1. Peruse the Memorandum of Association and Articles of Association of the entity.
2. Ensure the object clause permits the entity to engage in this type of business.
3. In the case of income from sale of tickets:
   (a) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
   (b) Verify the system of relating to on line booking of various shows and the system of realization of money.
   (c) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
4. Verify the internal control system and its effectiveness relating to the income from cafes shops, pubs etc., located within the multiplex.
5. Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
6. Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.
7. In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
8. Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.
9. Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.

PAPER – 6 : AUDITING AND ASSURANCE

QUESTIONS

Nature of Auditing

1. Comment on the following statements:

   (a) 'Accounting is a necessity, but auditing is a luxury.'

   (b) 'Auditing is a technique of accounting control.'

2. Examples of situations when the auditors' independence may be impaired include the following.

   (a) Providing taxation services to the company and its directors.

   (b) Providing accountancy services, including preparing periodic management accounts and annual financial statements.

   (c) Providing management consultancy, including advice on new computer systems and systems of internal control.

   (d) Preparing confidential reports to the company's bank and other lenders on the financial position of the client. The conclusions of these reports are note made available to the audit client.

   Requirement

   Describe how each of the situations listed above may compromise auditors' independence, and the ways in which an audit firm can minimise the effect which the provision of other services has on independence.

Basic Concepts in Auditing

3. What is the importance of having the accounts audited by independent professional auditors?

4. Briefly explain the nature of accounting policies. State any ten areas in which different accounting policies may be encountered.

Preparation for an Audit

5. What are the points to be considered while evaluating the "Knowledge of the Business" in the conduct of an audit?

6. **"**While adopting test cheque technique by the auditor for audit work certain precautions should be taken care to establish reliable idea about the true and fairness of the accounts". What precautions are to be taken in the application of test-checking techniques?

Internal Control

7. (a) In a large manufacturing concern, the management suspects inclusion of 'dummy workers' in wage sheets. What would you, as an auditor, suggest to detect such frauds?

(b) Your client, proprietor of a big retail store, wants protection against losses of sale proceeds. The client deals mainly in cash sales. Suggest a suitable system of internal check for the same.

8. You are appointed as an auditor of PQRS Pvt. Ltd.. PQRS Pvt. Ltd. reports the following position as on 31st March, 2010:

Paid up capital	30 lacs
Revaluation reserve	10 lacs
Capital reserve	11 lacs
P&T A/c [Dr. Balance]	2 lacs

The Management of the Company contends that CARO 2003 is not applicable to it. Comment.

Vouching &Verification of Assets and Liabilities

9. You are the Senior Audit Manager of a company's financial statements for the year ended 31st March, 20xx. What evidence would you look for to verify/vouch the following amounts appearing in the financial statements?

(a) Advertisement expenses ₹ 45,000

(b) Goodwill ₹ 1, 50,000

(c) Capital work-in-progress ₹ 85,250

(d) Wages paid to seasonal labourer ₹ 18,750

10. As an auditor, comment on the following situations/statements:

(a) You are the Auditor of a Manufacturing Company, whose year ends on 31st March. An event occurred after the year ended, but before you complete the audit. The audit report issued by you is dated 20th July. The Sales Ledger balance at 31st March was ₹ 95, 000. By 20^{h} July ₹ 65,000 only had been received against this amount as full and final payment.

(b) A computerised machinery was purchased by two companies jointly. The price was shared equally. It was also agreed that they would use the machinery equally and show in their Balance Sheets, 50% of the value of the machinery and charge 50% of the depreciation in their respective books of accounts.

11. (a) Give your comments and observations on the No entry is passed for cheques received by the auditee on the last day of the year, but not yet deposited with the bank.

(b) 'In vouching payments, the auditor does not merely check proof that money has been paid away.' Discuss.

12. (a) While conducting the audit of the accounts of a manufacturing company, you discover that the rate of Gross Profit on Sales has sharply risen in comparison to the previous year. State the steps you would take to satisfy yourself.

(b) As an auditor, how would you safeguard your client against payment for the fictitious purchases while verifying the purchases?

The Company Audit – I

13. Comment on the following:

(a) (i) In case the existing auditor(s) appointed at the Annual General Meeting refused to accept the appointment, whether the Board of Directors could fill up the vacancy.

(ii) Due to the resignation of the existing auditor(s), the Board of directors of X Ltd appointed Mr. Harry as the auditor. Is the appointment of Harry as auditor valid?

(b) At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted?

14. As a statutory auditor of a Public Limited Company, how would you deal with the following situations?

(a) The company has sold some old machinery for ` one crore. The details of the cost of such machinery are not available since the entire records relating to fixed assets have been destroyed in an earthquake.

(b) The company had subscribed to shares of associate companies amounting to ` 5 crores. These associate companies have incurred substantial losses and have been referred to BIFR for being declared as sick companies. The company does not want to make any provision for the fall in the value of the investments.

(c) As at the beginning of the year, the company has a capital of ` 2.50 crores, free reserves of ` 0.50 crore and Revaluation Reserve of ` 4.50 crores. In the relevant year under audit the company has incurred a loss of ` 4 crores. The company proposes to adjust the loss with the Revaluation Reserve.

The Company Audit – II

15. Part I, Schedule VI to the Companies Act, 1956, prescribes the form of balance sheet and the requirements relating thereto. What is the specific requirement as per Part I, Schedule VI to the Companies Act, 1956 relating to:

(a) Reserves and Surplus

(b) Current Liabilities and Provisions

16. (a) Can a construction company pay interest out of capital legally? If so, mention the various conditions under which it can do so?

(b) How would an auditor vouch/verify the following?

(i) Forfeiture of Shares.

(ii) Re-issue of Forfeited Shares

Special Audits

17. (a) You are appointed as an auditor of the Apollo Hospital. While conducting the audit of hospital accounts, briefly explain the considerations you will keep in mind.

    (b) Mention the special points to be examined by you as an auditor in the audit of a charitable institution situated in Jaipur.

18. (a) M/s. ABC Ltd., is a partnership firm, approaches you and enquires, whether under any statute it is necessary for a partnership firm, to get their accounts audited, if not than what are the advantage of such audit. You are required to explain the advantages of audit of accounts of a partnership firm?

    (b) Enumerate the matters those should be specially considered in the audit of accounts of a partnership.

Standards on Auditing and Guidance Notes

19. (a) "There should be sufficient liaison between a principal auditor and other auditors". Discuss the above statement and state in this context the reporting considerations, when the auditor uses the work performed by other auditor.

    (b) What are the considerations to be kept in mind while performing analytical procedures on data prepared by the client?

20. Write short notes on the following:

    (a) Financial indications to be considered for evaluating the assumption of going concern.

    (b) Auditor's responsibilities regarding comparatives.

    (c) Reporting on a compilation engagements

SUGGESTED ANSWERS/HINTS

Nature of Auditing

1. (a) Accounting is a necessity, but auditing is a luxury :

It is often told that accounting is a necessity, but auditing is a luxury. The first part of the statement is totally correct, but the correctness of the second part of the statement depends on the situation under which auditing is conducted.

Accounting is necessary to ascertain the financial result as well as financial position of an organisation. Whatever may be the nature, type and size of an organisation, each organisation has to adopt accounting to measure its own performance. In case of a business organisation, profit and loss account and balance sheet are prepared to ascertain the financial result as well as financial position of a particular period of time. Similarly, in case of non-profit seeking organisations, though the objective is not to earn profit, these organisations also prepare accounts to know the surplus generated. Without adopting accounting by maintaining books of accounts for recording financial and economic events, no organisation can maintain its scarce fund and it is also not possible to have idea about the incomes and expenses of the organisation. Hence, it is rightly said that accounting is a necessity.

Auditing is not a luxury in most of the cases. In case of company form of organisations, where ownership is totally separated from the management, auditing ensures the proper utilisation of fund provided by the shareholders and other loan providers. That is why, in the Companies Act, auditing has been made compulsory by introducing required provisions with a view to protect the interest of the shareholders and other interested parties. For the same reason, the co-operative societies and other statutory organisations are also required to conduct audit of their accounts. But auditing is not compulsory in case of sole-proprietorship and partnership firms. If the accounts of these types of organisations are maintained properly and if the proprietor or the partners are confident about the accuracy and reliability of the accounts maintained, then auditing may be considered unnecessary and to some extent luxury. However, if the accounts of these organisations are not audited, they will fail to enjoy some of the important benefits of conducting audit. The banks and other financial institutions provide loans on the basis of audited balance sheet and profit and loss account, the insurance companies settle their insurance claims on the basis of audited balance sheet and even if there is any disagreement among the partners regarding their accounts, the court will give decisions on the basis of audited accounts. Hence, it is inappropriate to say that auditing is a luxury. It is better to say that both accounting and auditing are required to know the true and fair view of the financial position and financial performance of an organisation.

(b) Auditing is a technique of Accounting Control:

The basic functions of accounting are to record the economic events that have the effect in changing the financial position of an organisation and to prepare the financial statements at the end of a particular accounting period. The objectives behind these functions of accounting are to know the financial result and the financial position of that organisation in a particular accounting period and at the end of the accounting period. The users of the financial statements include the management, the shareholders, creditors, investors, loan providing agencies and the public in general.

Auditors are appointed in these organisations to check the authenticity and reliability of the books of accounts maintained by these organisations and the relevant document preserved in order to support the transactions. After checking the books of accounts and relevant documents, the auditors are required to submit a report to the owners of the organisation. In the report, the auditors have to state as to whether the books of accounts maintained by the organisation give a true and fair view of the state of affairs of the organisation as disclosed in the financial statements. If the books of accounts fail to give a true and fair picture of the financial activities of that organisation, the auditor will report accordingly.

In the light of the above two concepts about the functions of accounting and auditing, it can be said that auditing is a technique of accounting control. In keeping the books of accounts or maintaining records through proper recording of economic events of an organisation, the accountants may make mistakes, i.e. accounting error may be there or they may adopt unfair practices to manipulate accounts to mislead the users. If there are accounting errors or frauds in the records and documents, the books of accounts will not disclose the true and fair view of the financial position of the organisation. In conducting audit, the auditor has to go through the entries recorded in the books of accounts and supporting documents to ensure him about the truth and fairness of the financial statements prepared on the basis of the books of accounts maintained. If he finds any inconsistency and irregularity in the books of accounts, he will raise objections and report accordingly. As a result, the persons involved in maintaining the books of accounts and relevant documents become very cautious in discharging their duties, because they know that if there is any irregularity in keeping the books of accounts, the auditor will report against the irregularity. So, the employees involved in maintaining the books of accounts want to be regular in their duties. Hence, it can be rightly said that accounting work is under the control of auditing work and auditing is a technique of accounting control.

2. (a) Taxation services

Many audit firms prepare tax computations for their client companies and this should not normally compromise independence.

Where taxation services are provided to the company, a conflict of interest could arise in dealing with the tax affairs of the directors (example if any of the directors are also shareholders, they may have preferences as to dividends or bonuses, which are not in the best interests of the company's tax or cash flow position).

There may also be independence issues in relation to tax advisory work. For example, the firm may have difficulty in giving an independent view on the acceptability of a scheme to the Revenue or Customs and Excise if the firm designed the scheme itself in the first place.

As a safeguard, a tax manager (or partner) independent of the audit function should be assigned to deal with individual director's tax affairs.

(b) Accountancy services

For many audit clients it is common to provide a range of accountancy services including participation in the preparation of accounting records. For listed or other public interest clients an audit firm should not participate in the preparation of the company's accounts and accounting records except in emergency situations.

Preparing periodic management accounts may draw the auditor, inadvertently, into performing management functions.

Safeguards for non-listed companies include the following.

- The client accepting responsibility for the records as its own.
- The auditor not assuming an operational role.
- Conducting appropriate audit tests on records processed/maintained- by the auditor.

(c) Management consultancy

An auditor's independence may be compromised if a course of action is recommended to an audit client. For example, if the auditor advises on a new computer system which is then found to be unreliable, the auditor may be reluctant to report the weaknesses to management.

As a safeguard auditors should lay the facts before the directors and let them make the decision. It is important that the auditor is not seen to be acting as part of the management function.

The additional guidance on best practice has also now provided that services involving the design and implementation of financial information technology systems (FITS) should not be provided unless

- Management accept overall responsibility in writing
- Management do not rely on the FITS work as the primary basis for determining the adequacy of internal controls and financial reporting systems, and
- The design specifications are set by management.

In any case separate engagement teams are likely to be necessary to mitigate the potential threat to independence.

(d) Preparing confidential reports

Auditors are not prevented from producing confidential reports for banks and other lenders, provided they have obtained the client's authority to do so.

An 'unqualified' confidential report recently issued to a lender may be borne in mind when forming the audit opinion. This may increase pressure not to qualify the audit opinion (to add credibility to the confidential report) when qualification is justified.

A partner other than the audit engagement partner should be responsible for the confidential reports. Unless confidentiality is absolutely necessary, the client should be made aware of the reports to lenders. The quality of these reports may be enhanced by consideration of management's views on matters included.

Basic Concepts in Auditing

3. Importance of Audit by an Independent Professional Auditor

The principal advantage of an independent audit lies in the fact that the society is able to get an informed, objective and forthright opinion on the financial statements of enterprises which are used in making significant economic decisions by interested segments of the society, e.g., shareholders, creditors, bankers, etc. Irrespective of the fact whether audit is compulsory, statutory or voluntary, the audit of accounts by an independent professional auditor becomes important for every individual and every type of organisation.

It is only through audited accounts by an independent professional auditor that the shareholders of a company are assured that the funds invested by them are safe and they are being used for only the purposes for which they were raised and collected. The chief utility of audit lies in ensuring reliable financial statements on the basis of which the state of affairs may be easy to understand. Information contained in the statement of accounts of a business is primarily intended for the owners.

However, many others make use of the information for different purposes.

- Management of the business uses it for decision-making purposes.
- Lenders and creditors examine it to establish the degree of safety of their money.
- Government levies tax putting a *prima facie* reliance on the statements and regulates the socio-economic state of affairs on a summary view of the information contained in various accounting statement made available to it.
- Investors review the information for making investment decisions
- Financial analysts can use the information to assess the performance of an entity.

Financial statements are of great significance to workers as well; they want to be assured that reasonable and legitimate share of the revenue earned by the organisation has been paid to them as bonus and the distribution pattern has not violated the norms of social justice.

To ensure the acceptable degree of reliability and accuracy of the financial statements, examination and appraisal of accounts and the financial picture by an independent auditor is necessary.

In the company form of organisation, there is a divorce between ownership and management - shareholders are so scattered that they have no direct control on the day- today administration of the company while in a proprietary concern, accounts may be audited to get funds from financial institution, etc. and a partnership firm may get its accounts audited to decide questions such as valuation of goodwill at the time of admission, retirement and death of a partner.

The report of an independent auditor is, therefore, the only real safeguard available to the various parties interested in the financial affairs of the entity. It is due to the independence of the auditor, leading to an objective report, that the risk of people being misled by untrue or fraudulent financial statement is minimised. As a by-product, managements get attuned to open and truthful financial statements.

4. Nature of Accounting Policies

Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

There is no single list of accounting policies which are applicable to all circumstances. The different circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise call for considerable judgment by the management of the enterprise.

The various statements of the Institute of Chartered Accountants of India combined with the efforts of government and other regulatory agencies and progressive managements have reduced in recent years the number of acceptable alternative particularly in the case of a corporate enterprise. While continuing efforts in this regard in future are likely to reduce the number still further, the availability of alternative accounting principles and methods of applying those stances faced by the enterprises.

Areas in which Different Accounting Policies are encountered

Areas in which different accounting policies may be encountered are:-

(i) Method of depreciation, depletion and amortization-Straight Line Method, Written Down Value method.

(ii) Treatment of expenditure during construction i.e. write off, capitalization, deferment.

(iii) Conversion or translation of foreign currency items-average rate, actual, TT buying rate etc.

(iv) Valuation of inventories – FIFO, LIFO, weighted average etc.

(v) Treatment of goodwill – write off, retain.

(vi) Valuation of investment –at cost, market or net realisable value etc.

(vii) Treatment of retirement benefits-Actuarial, funded through trust, insurance policy etc.

(viii) Recognition of profit on long term contracts –year to year, % completion etc.

(ix) Valuation of fixed assets-historical cost, revaluation price, exchange fluctuation etc.

(x) Treatment of contingent liabilities.

Preparation for an Audit

5. Knowledge of the Business :

The broad matters to be considered while obtaining knowledge of business for a new audit assignment are set out in SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment". These are:

(i) Relevant industry, regulatory, economic and other external factors including the applicable financial reporting framework

(ii) The nature of the entity, including:

(a) its operations;

(b) its ownership and governance structures;

(c) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and

(d) the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.

(iii) The entity's selection and application of accounting policies.

(iv) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

(v) The measurement and review of the entity's financial performance.

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgement regarding the appropriateness of accounting policies and disclosures.

6. The precautions that should be taken in applying test checking are-

(i) The transactions of the concern should be classified under appropriate heads and may be stratified if wide variations are there between transactions of same kind.

(ii) Systems and procedures of entering and processing a transaction right from the beginning to the end should be studied in a sequential order. It involves question of authorisation, documentation and recording, and evidencing the same.

(iii) The complete system of internal control in areas of accounts and finance should be studied and evaluated for its efficiency, soundness and capability for producing reliable accounting and financial data. This can be done by studying the controls and internal checks, evaluating their general soundness in the context of the business of the concern and testing their actual operation. Depending upon the auditor's satisfaction about the soundness of the controls and the operation of control systems, he should select a few transactions and check them in depth by the application of procedural tests.

(iv) A properly thought-out test check plan should be prepared and the objective of each check should be clearly understood by the auditing staff. For example, cash vouchers may be checked by the test check method for a number of objectives:

(a) One may be to ensure that the cash payments are properly authorised and acknowledged.

(b) Other may be to see whether the payment has been debited to the proper account, if there is a mix-up in the objectives or the objective is to be test a number of variables in one test scheme, the result may not be helpful. Hence, it requires a clear definition of the audit objective related to the particular test check plan.

(v) The transactions falling under such tests – check plan should be selected in a manner that bias does not enter the selection. For this purpose, selection should be made by reference to the random number tables.

(vi) Identification of the areas where test check may not be done. For example, if there are only 20 overseas sales in the year, it would be preferable to have them all thoroughly checked.

(vii) The number of transactions to be selected for each test check plan should be pre-determined. This can be done by deciding upon the degree of reliance that should be placed on the test-check results and the confidence that can be placed the results to be obtained should be veering round the degree of reliance set-up. Once the degree of reliance and the confidence level required in the audit for expression of the opinion have been decided, the number to be tested out of the given population can be easily known by reference to the statistical tables.

(viii) Materiality of the error as a result of test check must be pre-determined and criteria to be fixed to judge the same. Only the material errors may be properly and thoroughly investigated.

Internal Control

7. (a) Effective and appropriate internal control system should be adopted in order to detect the inclusion of the names of dummy workers in the wage sheets. The application of suitable internal check system depends on the nature and procedures of wage payment of the factory concerned. However, following outlines of the system can be suggested:

(i) Each worker should be provided with a time card or job card as the case may be. Proper records in detail about each worker must be maintained in such cards. The foreman in charge should initial the entries in the cards. At the end of the week or month, the card should be sent to wages office.

(ii) Due care should be given in the preparation of wage sheets. Wage sheets should not be prepared by those employees, who are responsible for recording the attendance of the workers. The work of wage sheet preparation should be assigned to a number of employees in such a way that the work done by one is automatically checked by the other.

(iii) Payment of wages should not be made by those employees, who have taken part in the preparation of wage sheet. It should be done by the cashier in the presence of a responsible officer and also the foreman, who can recognise the workers.

(iv) Proper records related to overtime authorised and granted to the workers must be maintained. For casual workers, separate records should he maintained.

(b) Internal Check for the Misappropriation of Cash out of the Sale Proceeds:

With a view to protect against the misappropriation of cash out of the sale proceeds by the salesmen, the following system of internal check is suggested:

(i) There should be complete segregation of responsibilities of the salesmen, the cashier and the accountant. Nobody should be allowed to do the job of others.

(ii) For each section, counter or department, separate salesman should be appointed.

(iii) As far as possible, mechanical cash register should be maintained.

(iv) The salesman should issue sales bills in triplicate. He should hand over two copies to the customer and retain the other copy.

(v) These two copies of the bill should be presented by the customer to the cashier.

(vi) The cashier should check the bill, receive the payment and stamp the bill as 'Paid'. Original copy of the bill should be handed over to the customer.

(vii) The customer should collect the goods purchased on presentation of the original bill, stamped as paid from another counter near the gate.

(viii) Each salesman should prepare the summary sheet with the help of the copy of the bill that remains with him and submit it to the accountant.

(ix) The cashier should enter the day's total sales in the cash sales sheet with the help of bill retained by him and report it to the accountant.

(x) Any discrepancy found by the accountant should be immediately reported to the general manager.

8. Applicability of CARO, 2003

As per the Statement on CARO, 2003 issued by ICAI, for determining the applicability of the CARO to a private limited company, both capital as well as the revenue reserves shall be taken into consideration while computing the limit of rupees fifty lacs prescribed for paid up capital and reserves. Revaluation reserve, if any, should also be taken into consideration while determining the figure of reserves for the limited purpose of determining the applicability of the Order. The credit balance in the profit and loss account should also be considered as a part of reserve since the balance in the profit and loss account is available for general purposes like declaration of dividend. The debit balance in the profit and loss account, if any, should be reduced from the figure of revenue reserves only. If the company does not have revenue reserves, debit balance of profit and loss account cannot be reduced from the figures of paid up capital, capital reserve and revaluation reserve.

Accordingly the profit and loss account (Dr Balance) of ` 2 lacs cannot be deducted and hence CARO, 2003 is applicable to the Company.

Vouching and Verification of Assets and Liabilities

9. (a) Advertisement E*xpenses* ` 45,000: The following steps may be taken by the auditor to vouch/verify the different items:

(i) Ascertaining the value of advertisement expenses to ensure that the said expense has been properly allocated.

(ii) Examining that such expenses relate to the client's business.

(iii) Review and examination of the complete list of media of advertisement indicating the dates, location, timing, etc., along with the amounts paid in respect of each category.

(iv) Examination of the receipts for amounts paid.

(v) Reviewing the contracts with the different agencies and ensuring that the billing conforms to the term and conditions specified therein.

(vi) Ensuring that all such outstanding expenses have been properly accounted for.

(b) Goodwill ` 1,50,000: Goodwill arises from business connections, trade name or reputation of an enterprise. AS 26, "Intangible Assets", states that internally generated goodwill is not to be recognised as an asset, as it is not an identifiable resource controlled by the enterprise, which can be measured reliably at cost. As per AS 10, "Accounting for Fixed Assets", goodwill should be recorded in the books, only when some consideration in money or money's worth has been paid for it. In light of the above discussions, the following points are to be noted for verification of goodwill:

(i) Examine the vendors' agreement on the basis of which assets of the running business have been acquired by the company as per the books of account or a specific amount has been paid for the goodwill.

(ii) Ensure that whenever business is acquired at a price, payable in cash or otherwise, which is in excess of the value of net assets taken over, such excess amount is the goodwill.

(iii) Ensure that only the amount paid to the vendors not represented by tangible or intangible assets, the value of which can be measured reliably has been debited to goodwill account.

(iv) See that goodwill has not been shown in the company's books by writing up the value of its assets, on revaluation, or by writing back the amount of goodwill earlier written off.

(v) Ensure that the goodwill not yet written off has been properly disclosed under the head "Fixed Assets" as per Schedule VI requirements.

(vi) See that the goodwill is being amortised as per financial prudence over a reasonable period.

(c) Capital Work-in-Progress ` 85,250: Capital Work-in-Progress denotes assets under installation. This could either be plant or machinery under construction, or that construction project for establishment of a new factory is under progress. The auditor should take the following steps to verify the same.

(i) Ensure that the capital project is authorised by the Board. See the relevant Board Minutes for the purpose.

(ii) Obtain the break up in details of the amount shown in the Balance Sheet under this head.

(iii) Check purchase cost of plant, machinery or other assets with reference to the contract with, and amount paid to the suppliers.

(iv) Examine the allocation of common costs to the Capital Work-in-Progress in case such items have been constructed internally.

(v) Ensure that the assets already put to commercial use are not included under Capital Work-in-Progress.

(vi) Verify that only expenses incurred up to pre-commissioning stage are capitalised under this head.

(vii) Obtain the certificate of the engineering department to ascertain the quantum of the Capital Work-in-Progress, and whether the value is correctly represented in the Balance Sheet, and its transfer to Fixed Assets on completion of the project or installation of the plant.

(viii) See that Capital Work-in-Progress is properly disclosed in the Balance Sheet under the head Fixed Assets.

(d) Wages Paid to Seasonal Labourers ` 18,750

(i) Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers.

(ii) Examine that these labourers are hired on proper authority and the rates of pay are authorized at appropriate levels.

(iii) Ensure that the attendance is properly checked by the Time Keeping Department.

(iv) Check that the certificate regarding work done by the labourers has been given by the proper person, in case the labourers have been appointed on a per piece basis.

(v) Check the computation of wages payable to the labourers, after taking into account the deductions.

(vi) Confirm that all the payment to the labourers have been acknowledged.

(vii) See the time and job records, to ensure that the labourers have been paid for time worked. See the treatment of abnormal idle time.

(viii) Reconcile the number of seasonal labourers on payroll as per the Personnel Department's records vis-à-vis the number of labourers to whom the wages have been paid, to ensure that there are no ghost workers. This assumes greater importance, if the seasonal labourers are hired on temporary basis, and not on permanent payroll.

10. (a) Consideration of Subsequent Events: SA 560 "Subsequent Events" requires that the auditors should consider the effect of subsequent events on the financial statements and the auditor's report. Depending upon the nature of subsequent event, i.e., adjusting event or non-adjusting event, the auditor has to examine the impact on financial statements. AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" also classifies an adjusting event which provides further evidence of conditions that existed at the balance sheet date after balance sheet date, the effect of such events have to be seen by the auditor on figures contained in the financial statements. The facts indicated in the question clearly reveal that subsequent realisation has been good. Such consideration helps the auditor in assuring the existence of debtors as also the realisability aspect. The auditor's duties in respect of debtors remaining uncollected at the time of giving audit report involves examination of actual past experience of collections from debtors. Further the auditor has to see that how much provision was assessed in respect of bad and doubtful debts having regard to recovery position, due date, legal cases, cheques dishonoured, etc. as on March 31, 2004. Accordingly, the auditor would have now to see that in respect of outstanding amount of rupees 35,000, whether the amount of provision needs any revision.

(b) Joint Assets: AS 10, "Accounting for Fixed Assets", issued by the Institute, prescribes that in case of fixed assets owned jointly by enterprises, the extent of the entity's share in such assets, and the proportion in the original cost, accumulated depreciation and written down value should be stated in the Balance Sheet. Accordingly, the treatment followed by the companies reflecting 50% of the value of the machinery and changing 50% depreciation in their respective books of account is proper. However, such jointly owned assets should be indicated separately in the Fixed Assets Register maintained by the company.

(Note: Alternatively, AS 10 also recommends that the pro-rata cost of such jointly owned assets may be grouped together with similar fully owned assets and appropriate disclosure of the same should be made.)

11. (a) Cheques Received on the last day of Accounting Year: It is quite normal that in any on going business entity many a time's cheques are received from the customers on the last day of the accounting year. It is also quite likely, that cheques received on the last day of the accounting year could not be deposited in the bank. Though normally speaking, it is expected that all cheques should be deposited in the bank daily. But there may be a possibility that such cheques which are received particularly during the late hours could not be deposited in the bank. Therefore, it is quite important to ensure that the system of internal control is effective and such cheques should be properly accounted for to avoid any frauds and that the financial statements reflect a true and fair view.

As far as internal control system is concerned, it should be ensured that a list of such cheques is prepared in duplicate and a copy of the same has been sent to person controlling the debtors' ledger and a second copy is handed over to cashier along with the cheques received. The person who is controlling the debtors' ledger should ensure that proper accounting entries have been passed by crediting respective debtors' accounts. The balance of cheques-in-hand should also be disclosed along with the cash and bank balances in the financial statements.

(b) Vouching is a substantive audit procedure which aims at verifying the genuineness and validity of a transaction contained in the accounting records. It involves examination of documentary evidence to support the genuineness of transaction. Thus the object of vouching is not merely to ascertain that money has been paid away; but the auditor aims to obtain reasonable assurance in respect of following assertions in regard to transactions recorded in the books of account that –

(i) a transaction is recorded in the proper account and revenue or expense is properly allocated to the accounting period;

(ii) a transaction pertains to entity and took place during the relevant period;

(iii) all transactions which have actually occurred have been recorded;

(iv) all transactions were properly authorised; and

(v) transactions have been classified and disclosed in accordance with recognised accounting policies and practices.

Thus, it is through vouching that the auditor comes to know the genuineness of transactions recorded in the client's books of account wherefrom the financial statements are drawn up.

Apart from genuineness, vouching also helps the auditor to know the regularity and validity of the transaction in the context of the client's business, nature of the organisation and organisational rules.

Thus, the auditor's basic duty is to examine the accounts, not merely to see its arithmetical accuracy but also to see its substantial accuracy and then to make a report thereon.

This substantial accuracy of the accounts and emerging financial statements can be known principally by examination of vouchers which are the primary documents relating to the transactions. If the primary document is wrong or irregular, the whole accounting statement would, in turn, become wrong and irregular. Precisely auditor's role is to see whether or not the financial statements are wrong or irregular, and for this, vouching is simply imperative. Thus, vouching which has traditionally been the backbone of auditing does not merely involve checking arithmetical accuracy but goes much beyond and aims to check the genuineness as well as validity of transactions contained in accounting records

12. (a) There are several possible causes of the sharp increase in the rate of gross profit on sales as compared with that of the previous year; the most likely causes are as under:

(i) *Increase in Sales Prices:* The selling price of the finished products may have been increased. Enquiries should be made by auditor as to whether there have been general or specific price increase and the reasons for the same. The auditor should obtain copies of the company price lists prevailing at different point of time and make the relevant comparison.

(ii) *Reduction in Cost of Manufacturing:* The cost of manufacturing may have reduced substantially. The auditor should examine the stock and purchases records in respect of large purchases of raw materials, comparing current costs with those in the previous year and detailed information supporting the possibility should be sought from the company.

(iii) *Alteration in Sales-mix:* The mix of sales may have been altered, resulting in the sales of more profitable items. Detailed sales analysis should be made for the period in order to ascertain whether the more profitable lines constituted a large proportion of the total sales.

(iv) *Impact of Automation*: The mechanisation or automation of certain manufacturing processes may have resulted in considerable saving in labour cost and this possibility could be easily verified by comparisons of wages records.

(v) *Adherence to Cut-off Procedures:* The company cut-off procedures as regards closing stock and work-in-progress should be investigated, as any change in the procedure as compared with the previous year would cause a difference in the gross profit ratio. It should also be seen that the procedure laid down has been observed by the concerned personnel and rightly adhered to. The auditor should test relevant transaction and ensure that everything is incorporated in the financial statement.

(vi) *Manipulating Sales*: The possibility of items which have been sent to customers on 'sale or return' basis being included in sales should be investigated, as this would give effect for increase in the rate of gross profit.

(b) The auditor has to be very cautious while verifying the purchases that no payments have been made for the fictitious purchases. For this purpose, he may have to take the following actions:

- He should examine first the internal control system in connection with purchases and satisfy himself with regard to its effectiveness.
- He should ensure that before passing the invoices for payment, they are checked with the original order, with goods received book and the stock records.
- He should inspect the invoices and see that the authorities responsible for passing them for payment have duly checked them and initialled.

- He should test check the invoices to see that-dates given in the invoices are for the period concerned and they have been addressed in the name of the client.
- He should also compare a number of invoices with the records in the goods received book and stock records.
- He can make physical verification of the goods purchased, if a part of it is still in the stock.
- He should also compare the supplier's statement with the supplier's account.
- Postings in the various suppliers' accounts should also be checked and compared with the statement received from them.

The Company Audit – I

13 (a) (i) ***Board's Powers to Appoint an Auditor*** : The appointment of an auditor is complete only on the acceptance of the offer by the auditor. The non-acceptance of appointment by the auditor does not result in any casual vacancy. Moreover, even if the auditor is existing one, the matter would not make any difference since the appointment has to be made at each AGM and the auditor must accept the same. The casual vacancy is said to arise only in case of death, resignation, etc. Therefore, the Board is not empowered to fill such a vacancy. Thus, the Board of Directors are not authorised to fill up the vacancy in case the existing auditor (s) appointed at the Annual General Meeting refuse to accept the appointment.

(ii) ***Board's Powers to Appoint an Auditor*** **:** The resignation of the existing auditor(s) would give rise to a casual vacancy. As per Section 224(6) (a) of the Act, casual vacancy can be filled by the Board of Directors, provided such vacancy has not been caused by the resignation of the auditor. The rationale behind such a provision is to ensure that resignation is a matter of great concern and, thus, it is necessary that all shareholders must be apprised of reasons connected with resignation in case of a casual vacancy arising on account of resignation. The vacancy shall only be filled by the company in general meeting. Thus the appointment of Mr. Harry as the auditor of the company is not valid.

(b) ***Restrictions on Powers of Statutory Auditors*****:** Section 227(1) of the Companies Act, 1956 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence' any such resolution even if passed by entire body of shareholders is *ultra vires* and therefore void. In the case of *Newton vs. Birmingham Small Arms Co.*, it was held that any regulations which preclude the auditors from availing themselves of all the information to which they are entitled under the Companies Act, are inconsistent with the Act.

14. (a) Sale of Machinery: AS 10 on "Accounting for Fixed Assets", gains or losses arising on disposal are generally recognised in the profit and loss statement. Therefore, when the company sells old machinery, profit or loss on sale thereof has to be determined. Such profit or loss can be determined provided the cost and written down value of the said machinery is available. In the instant case, since the entire records of fixed assets have been destroyed, the cost and the WDV of the machinery sold could not be arrived at. The company may therefore, have to determine the same on some estimated basis provided all reasonable efforts to determine the cost/WDVs of the machinery do not yield any better result. An all out attempt should be made by the management to reconstruct the old records. Such records may be constructed by obtaining old copies of annual reports distributed amongst shareholders, annual accounts filed with Registrar of Company, IT Returns filed by the auditor may also be having record of physical verification of earlier years etc. In fact, through this process, the company shall be able to determine the WDV of the asset because the machinery sold seems to be quite big and must have been recorded on stand alone basis.

The auditor will have to see whether the estimate of cost and WDV arrived at in the above manner by the company is reasonable and whether the profit or loss is determined accordingly. A note to that effect would also have to be given by the management in the accounts. If the auditor is of the opinion that the said estimates are satisfactory based on available records and the note given by management explains the said fact, he may not qualify his report. If he is not so satisfied, he would have to give disclaimer in the audit report that in the absence of proper records, the said profit or loss has been arrived on an estimated basis and in that view he has been unable to form an opinion. As far as the report under the CARO, 2003 order is concerned, the auditor would have to point out that proper records of fixed assets showing full particulars as required by that clause are not available.

(b) Valuation of Investments: AS 13 on "Accounting for Investments" requires investments to be classified as long term and current investments distinctly in its financial statements. Since the investment in share of associate company is intended to be kept for a period more than one year, they would be classified as long term investment.

AS 13 states, "long-term investments should be carried in the financial statements at cost." However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. In the instant case, these associate companies have incurred substantial losses and have been referred to BIFR for being declared as sick companies. The net worth of these companies would have been wiped out resulting in a fall in the value of the investments. Therefore, such fall cannot be merely temporary as the companies could take a long time to turn around (if at all) and again have a positive net worth. The auditor would therefore have to qualify his report by saying that no provision for diminution for fall in the value of investments as required by AS 13 has been made and to that extent the profits and reserves have been overstated.

(c) Adjustment of Loss against Revaluation Reserve: AS 10 on "Accounting for Fixed Assets" states that an increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution. A decrease in net book value arising on revaluation of fixed assets is charged to profit and loss statement except that, to the extent that such a decrease is considered to be related to a previous increase on revaluation that is included in revaluation reserve, it is sometimes charged against that earlier increase. It sometimes happens that an increase to be recorded is a reversal of a previous decrease arising on revaluation which has been charged to profit and loss statement in which case the increase is credited to profit and loss statement to the extent that it offsets the previously recorded decrease. The Guidance Note on "Treatment of Reserve created on Revaluation of Fixed Assets" states that where the value of fixed assets is written up in the books of account of a company, the corresponding credit appearing as revaluation reserve does not represent a realised gain and is, therefore, not available for distribution as dividend. Similarly, accumulated losses and the depreciation on the acquisition cost (including arrears of depreciation) should not be adjusted against revaluation reserve since this would amount to setting off actual losses against unrealised gains.

The auditor should explain to the management that accumulated losses cannot be adjusted against the revaluation reserve created on revaluation of the fixed assets. In case the company in question does so, the balance sheet of the company will not reflect a true and fair view of the state of affairs of the company keeping in view the magnitude of the amounts involved, i.e., accumulated losses amount to ` 4 crores and share capital and reserves amount to ` 3 crores (excluding revaluation reserve). If the management does not agree with the opinion of the auditor, the auditor may even issue an adverse report.

The Company Audit – II

15 (a) ***Reserves and Surplus**:* This item should be classified as under:

1. Capital Reserves.
2. Capital Redemption Reserve.
3. Share Premium Account.
4. Other Reserves specifying the nature and amount of each Reserve.
5. Surplus.

6. Proposed additions to Reserves.
7. Sinking Funds.

Under each of the above specific heads, the balance as per last balance sheet, additions thereto and deductions therefrom should be stated.

The word "fund" in relation to any "Reserve" should be used only where such Reserve is specifically represented by earmarked investments.

In respect of the Share Premium Account, details of its utilisation in the manner provided in section 78 should be given in the year of utilisation.

In respect of other reserves, the nature and the amount of each reserve should be specified.

Any debit balance in the Profit and Loss Account should be shown as a deduction from the uncommitted reserves, if any.

The expression "Uncommitted reserves', would not include reserves set apart for a specific purpose such as reserve for doubtful debts, investment, fluctuation reserve, etc.

Under "Surplus" should be shown the balance in the Profit and Loss Account after providing for proposed allocations, namely, Dividend, Bonus or allocations to Reserves.

While classifying the items between Reserves and Provisions regard must be had to the definitions of these items given in Part III, Schedule VI, and accordingly any provision in excess of the amount reasonably necessary should be classified as a reserve.

(b) ***Current Liabilities and Provisions***: Current Liabilities and Provisions are required to be grouped separately as under:

(A) Current Liabilities

1. Acceptances.
2. Sundry Creditors.
   (i) Total outstanding dues of micro enterprises and small enterprises; and
   (ii) Total outstanding dues of creditors other than micro enterprises and small enterprises.
3. Subsidiary Companies.
4. Advance payments and unexpired discounts for the portion for which value has still to be given, *e.g.,* in the case of the following classes of companies :

   Newspaper, Fire Insurance, Theatres, Clubs, Banking, Steam-ship Companies, etc.

5. Investor Education and Protection Fund shall be credited by the following amounts namely:
   (a) Unpaid dividend;
   (b) Unpaid application money received by the companies for allotment of securities and due for refund;
   (c) Unpaid Matured Deposits;
   (d) Unpaid Matured Debentures;
   (e) Interest accrued on (a) to (d) above.
6. Other Liabilities.
7. Interest accrued but not due on loans.

(B) Provisions

8. Provision for Taxation.
9. Proposed Dividends.
10. For Contingencies.
11. For Provident Fund Scheme.
12. For Insurance, pension and similar staff benefit schemes.
13. Other provisions.

The items should be classified as “Provision” of “Liabilities” having regard to the definitions of these terms in Part III, Schedule VI.

Current accounts with directors and manager, whether they are in credit or debit, should be shown separately.

It should be noted that interest accrued but not due on loans, whether secured or unsecured, is required to be shown under “Current Liabilities”.

The provision for taxation, if in excess of the amount, which in the opinion of the directors, is reasonably necessary for the purpose, should be classified as a “Reserve”.

The name(s) of the small scale industrial undertaking(s) to whom the company owe any sum together with interest outstanding for more than 30 days are to be disclosed.

16. (a) In general, a company cannot pay interest out of its capital. It is only when a company has been formed to undertake some construction or other related work and would not be able to earn sufficient profits for some years, it can legally pay interest on the paid-up capital.

According to Sections 208(2) to 208(7) of the Companies Act, 1956 the following conditions must be fulfilled before such payment can be made:

- Payment must be authorised by the Articles or by a special resolution.

- No such payment, even though authorised as mentioned above, shall be made without the previous sanction of the Central Government.
- The Central Government may, at the expense of the company, appoint a person to inquire into the circumstances and to report to the Central Government.
- The payment of interest shall be made only for such periods as may be determined by the Central Government.
- The rate of interest, in no case, exceeds 4% per annum or such other rate as the Central Government may direct by a notification in the official gazette.
- The payment of interest shall not operate as a reduction of the amount paid-up on the shares in respect of which it is paid.

(b) (i) Forfeiture of Shares

The auditor should:

(1) ascertain that the Articles authorise the Board of Directors to forfeit shares and that the power has been exercised by the Board in the best interest of the company;

(2) verify the amount of call or instalment of calls which was outstanding in respect of each of the share forfeited;

(3) ascertain that the procedure in the Articles has been followed, viz., the notice given (14 days, according to Table A) to the defaulting shareholders, warning them that in the event of non-payment, by a specified date, of the amount of call already made on the shares standing in their names, together with interest, if any, the shares shall be forfeited; see that the proper resolutions of Directors, first as regards issuance of notice and afterwards in respect of forfeiture of shares; and

(4) verify the entries recorded in the books of account consequent upon forfeiture of shares to confirm that the premium, if any, received on the issue of shares has not been transferred to the Forfeited Shares Account.

(ii) Re-issue of Forfeited Shares

The auditor should:

(1) ascertain that the Board of Directors has the authority under the Articles to re-issue forfeited shares;

(2) refer to the resolution of the Board of Directors, re-allotting forfeited shares;

(3) vouch the amounts collected from person to whom the shares have been allotted and verify the entries recorded from re-allotment and see that the total amount received on the share, including that received prior to forfeiture, is not less than the par value; and

(4) verify that computation of the amount of surplus resulting on the reissue of shares credited to the Capital Reserve Account; and

(5) where partly paid shares are forfeited for non-payment of call, and are re-issued as fully paid, the re-issue is treated as an allotment at a discount *Biochemical and Synthetic Products Ltd.* v. *Registrar of Companies* [(1962) 32 Comp. Case 654]. In such a case the provisions of Section 79 would require compliance.

Special Audits

17. (a) Audit of Hospital

The special steps involved in such an audit are stated below;

(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 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 receipts, 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 the 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 authorities 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 receipt and issue of stores; medicines, linen, 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 scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.

(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 Charitable Institutions

In the case of the audit of a charitable institution, attention should be paid to the following matters :

(i) *General*

(a) Studying the constitution under which the charitable institution has been set up. It may be registered as a society under the Societies Registration Act, 1860 as a company limited by guarantee or as a trust. If the charitable institution is a public trust, the provision of the State Legislation, if any, affecting its accounts and audit should be taken into account.

(b) Verifying whether the institution is being managed in the manner contemplated by the law under which it has been set up.

(c) Examining the system of internal check, especially as regards accounting of amounts collected.

(d) Verifying in detail the income and confirming that the amounts received have been deposited in the bank regularly and promptly.

(ii) *Subscriptions and donations*

(1) Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.

(2) Whether official receipts are issued;

(a) confirming that adequate control is imposed over unused receipt books;

(b) obtaining all receipt books covering the period under review;

(c) test checking the counterfoils with the cash book; any cancelled receipts being specially looked into;

(d) obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;

(e) examining the system of internal check regarding moneys received from box collections, flag days, etc. and checking the amount received from representatives, with the correspondence and the official receipts issued; paying special attention to the system of control exercised over collections and the steps taken to ensure that all collections made have been accounted for; and

(f) verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

(iii) *Legacies* - Verifying the amounts received by reference to correspondence with any figures and other available information.

(iv) *Grants*

(a) Vouching the amount received with the relevant correspondence, receipts and minute books.

(b) Obtaining a certificate from a responsible official showing the amount of grants received.

(v) *Investments Income*

(a) Vouching the amounts received with the dividend and interest counterfoils.

(b) Checking the calculations of interest received on securities bearing fixed rates of interest.

(c) Checking that the appropriate dividend has been received where any investment has been sold ex. dividend or purchased cum. dividend.

(d) Comparing the amounts of dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.

(vi) *Rents*

(a) Examining the rent roll and inspecting tenancy agreements, noting in each case :

(1) The amounts of the rents, and

(2) The due dates.

(b) Vouching the rents on to the rent roll from the counterfoils of receipt books and checking the totals of the cash book.

(vii) *Special function, etc.* - Vouching gross receipts and outgoings in respect of any special functions, *e.g.* concerts, dramatic performance, etc., held in aid of the charity with such vouchers and cash statements as are necessary. In particular, verifying that the proceeds of all tickets issued have been accounted for, after making the allowance for returns.

(viii) *Income Tax Refunds* - Where income-tax has been deducted from the Investment income, it should be seen that a refund thereof has been obtained since charitable institutions are exempt from payment of Income-tax. This involves :

(a) vouching the Income-tax refund with the correspondence with the Income-tax Department; and

(b) checking the calculation of the repayment of claims.

(ix) *Expenditure*

(a) Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the Managing Committee has benefited therefrom either directly or indirectly.

(b) Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test-basis.

(c) Verifying the cash and bank balances.

(d) Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

18. (a) Advantages of Audit of a Partnership Accounts

The advantages of audit of accounts of a partnership could be stated as follows:

(i) Audited accounts provide a convenient and reliable means of settling accounts between the partners and, thereby, the possibility of occurrence of a dispute among them is mitigated. On this consideration, it is usually provided in and accepted by the partners, shall be binding upon them, unless some manifest error is brought to light within a specified period subsequent to the accounts having been signed.

(ii) On the retirement or death of a partner, audited accounts, which have been accepted by the partners, constitute a reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.

(iii) The accounts of a partnership, which have been audited, are generally accepted by the Income Tax Department as the basis for computing the assessable income of the partners and also for the settlement of their liability in respect of Wealth Tax.

(iv) Audited statements of accounts are relied upon by the banks when advancing loans, as well as by prospective purchasers of the business, as evidence of the profitability of the concern and its financial position.

(v) Audited statements of account can be helpful in the negotiations to admit a person as a partner, especially when they are available for a number of past years.

(vi) An audit is an effective safeguard against any undue advantage being taken by a working partner or partners especially in the case of those partners who are not actively associated with the working of the firm.

(b) Specific Matters to be considered in Audit of a Partnership Accounts

Matters which should be specially considered in the audit of accounts of a partnership are:

(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets extraordinary contracts entered into and other such matters as are not of a routine nature.

(iii) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(iv) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(v) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements.

(vi) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.

(vii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

From the foregoing steps involved in the audit of a partnership it would be observed that like the audit of every other commercial undertaking, it culminates in the verification of the Balance Sheet and the Profit and Loss Account to ensure that these exhibit a true and fair state of affairs of the firm.

Standards on Auditing and Guidance Notes

19. (a) SA 600 on "Using the Work of Another Auditor" lays down the procedure to be applied in situations where a principal auditor reporting on the financial statement of the entity uses the work of another independent auditor. SA 600 contemplates coordination between auditors and requires that there should be sufficient liaison between the principal auditor and the other auditor. For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor.

The other auditor, knowing the context in which his work is to be used by the principal auditor, should co-ordinate with the principal auditor. For example, by bringing to the principal auditor's immediate attention any significant findings requiring to be dealt with at entity level, adhering to the time-table for audit of the component, etc. He should ensure compliance with the relevant statutory requirements. Similarly, the principal auditor should advise the other auditor of any matters that come to his attention that he thinks may have an important bearing on the other auditor's work.

When considered necessary by him, the principal auditor may require the other auditor to answer a detailed questionnaire regarding matters on which the principal auditor requires information for discharging his duties. The other auditor should respond to such questionnaire on a timely basis.

When the principal auditor concludes, based on his procedures, that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit.

In all circumstances, if the other auditor issues, or intends to issue, a modified auditor's report, the principal auditor should consider whether the subject of the modification is of such nature and significance, in relation to the financial information of the entity on which the principal auditor is reporting that it requires a modification of the principal auditor's report

(b) As per SA 520 "Analytical Procedure", when the auditor intends to perform analytical procedures on data prepared by the client, he should consider the following:

(i) Objective of such procedures and the extent to which he may be able to rely on their results.

(ii) Nature of the entity and the degree to which information can be disaggregated; for example, analytical procedures may be effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.

(iii) Availability of information, both financial, such as budgets or forecasts, and nonfinancial such as the number of units produced or sold.

(iv) Reliability of the information available

(v) Relevance of the information available

(vi) Sources of information available

(vii) Comparability of the information available

(viii) Knowledge gained by the auditor during previous examinations.

(ix) Testing the controls over the preparation of non financial information, if any, used in applying analytical procedures.

20. (a) Financial Indications to be considered for evaluating the assumption of going concern:

SA 570 "Going Concern", aims to establish standards on the auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements. The following are the financial indications be considered:

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of Going Concern renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financial Statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.
- Entering into a scheme of arrangement with creditors for reduction of liability.

(b) Auditor's responsibilities regarding comparatives:

SA 710, "Comparative Information - Corresponding Figures and Comparative Financial Statements", establishes standards on the auditor's responsibilities regarding comparatives. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

(i) The comparative information agrees with the amounts and other disclosures presented in the prior period; and

(ii) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 (Revised) "Subsequent Events".

As required by SA 580 (Revised)"Written Representation", the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

(c) Reporting on a Compilation Engagements:

As per SRS 4410 "Engagements to Compile Financial Information", the report on compilation engagements should, ordinarily, be in the following lay out:

(i) *Title*: The title of the report should be "Accountant's Report on Compilation of Unaudited Financial Statements" (and not "Auditor's Report");

(ii) *Addressee*: The report should ordinarily be addressed to the appointing authority;

(iii) Identification of the financial information also, noting that it is based on the information provided by the management;

(iv) When relevant, a statement that the accountant is not independent of the entity;

(v) A statement that the management is responsible for:

- Completeness and accuracy of the underlying data and complete disclosure of all material and relevant information to the accountant;
- Maintaining adequate accounting and other records and internal controls and selecting and applying appropriate accounting policies;
- Preparation and presentation of financial statements or other financial information in accordance with the applicable laws and regulations, if any;
- Establishing controls to safeguard the assets of the entity and preventing and detecting frauds or other irregularities;
- Establishing controls for ensuring that the activities of the entity are carried out in accordance with the applicable laws and regulations and preventing and detecting any non-compliance;

(vi) A statement that the engagement was performed in accordance with this Standard on Related Services*;*

(vii) A statement that neither an audit nor a review has been carried out and that accordingly no assurance is expressed on the financial information;

(viii) A paragraph, when considered necessary, drawing attention to the disclosure of material departures from the identified financial reporting framework;

(ix) Date of the report;

(x) Place of signature; and

(xi) Accountant's signature

The financial statements or other financial information compiled by the accountant should contain a reference such as "Unaudited," "Compiled without Audit or Review" and also "Refer to Compilation Report" on each page of the financial information or on the front of the complete set of financial statements.

ANNEXURE

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR MAY, 2011 EXAMINATION

The following List of Institute's Publications is relevant for the forthcoming examination i.e. May, 2011. Students may kindly take it into consideration while preparing for the examination.

Integrated Professional Competence Course

Paper 6 : Auditing and Assurance

I. Statements

1. Statement on Reporting under Section 227 (1A) of the Companies Act, 1956
   http://220.227.161.86/18799announ10264b.pdf
2. Statement on the Companies (Auditor's Report) Order, 2003 (2005 Edition)
   http://220.227.161.86/18798announ10264a.pdf

II. Standards on Auditing (SAs)

S.No	SA	Title of Standard on Auditing	Effective Date
1	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing http://220.227.161.86/18132sa200_rev.pdf	April 1, 2010
2	SA 210	Agreeing the Terms of Audit Engagements http://220.227.161.86/16837sa210revised.pdf	April 1, 2010
3	SA 220	Quality Control for an Audit of Financial Statements http://220.227.161.86/18133sa220_rev.pdf	April 1, 2010
4	SA 230	Audit Documentation http://220.227.161.86/15372Link7_SA230-standard.pdf	April 1, 2009
5	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements http://220.227.161.86/15374Link9_240SA_REVISED.pdf	April 1, 2009
6	SA 250	Consideration of Laws and Regulations in An Audit of Financial Statements http://220.227.161.86/15376Link11_SA250-text.pdf	April 1, 2009

7	SA 260	Communication with Those Charged with Governance http://220.227.161.86/15378Link13_SA%20260-text.pdf	April 1, 2009
8	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management http://220.227.161.86/16838sa265.pdf	April 1, 2010
9	SA 299	Responsibility of Joint Auditors http://220.227.161.86/15379Link14_299SA-AAS12.pdf	April 1, 1996
10	SA 300	Planning an Audit of Financial Statements http://220.227.161.86/15381Link16_300SA_REVISED.pdf	April 1, 2008
11	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment http://220.227.161.86/15382Link17_315SA.pdf	April 1, 2008
12	SA 320	Materiality in Planning and Performing an Audit http://220.227.161.86/16839sa320revised.pdf	April 1, 2010
13	SA 330	The Auditor's Responses to Assessed Risks http://220.227.161.86/15384Link19_330SA.pdf	April 1, 2008
14	SA 402	Audit Considerations Relating to an Entity Using a Service Organization http://220.227.161.86/16840sa402revised.pdf	April 1, 2010
15	SA 450	Evaluation of Misstatements Identified during the Audits http://220.227.161.86/16841sa450revised.pdf	April 1, 2010
16	SA 500	Audit Evidence http://icai.org/resource_file/15576sa500revised.pdf	April 1, 2009
17	SA 501	Audit Evidence - Specific Considerations for Selected Items http://220.227.161.86/18134sa501_rev.pdf	April 1, 2010
18	SA 505	External Confirmations http://220.227.161.86/18135sa505_rev.pdf	April 1, 2010
19	SA 510	Initial Audit Engagements-Opening Balances http://220.227.161.86/15390Link25_510text.pdf	April 1, 2010
20	SA 520	Analytical Procedures http://220.227.161.86/18136sa520_rev.pdf	April 1, 2010
21	SA 530	Audit Sampling http://220.227.161.86/15393Link28_530text.pdf	April 1, 2009
22	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures http://220.227.161.86/15395Link30_540text.pdf	April 1, 2009
23	SA 550	Related Parties http://220.227.161.86/15397Link32_550text.pdf	April 1, 2010
24	SA 560	Subsequent Events http://220.227.161.86/15399Link34_SA%20560_Standard_OK OK.pdf	April 1, 2009
25	SA 570	Going Concern http://220.227.161.86/15401Link36_SA570-final_standard.pdf	April 1, 2009
26	SA 580	Written Representations http://220.227.161.86/15403Link38_sa580.pdf	April 1, 2009
27	SA 600	Using the Work of Another Auditor http://220.227.161.86/18836sa600_aas.pdf	April 1, 2002
28	SA 610	Using the Work of Internal Auditors http://220.227.161.86/16842sa610revised.pdf	April 1, 2010

29	SA 620	Using the Work of an Auditor's Expert http://220.227.161.86/18137sa620_rev.pdf	April1, 2010
30	SA 700	Forming an Opinion and Reporting on Financial Statements http://220.227.161.86/17874sa700annx1.pdf	April 1, 2011
31	SA 705	Modifications to the Opinion in the Independent Auditor's Report http://220.227.161.86/17875sa705annex2.pdf	April 1, 2011
32	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report http://220.227.161.86/17876sa706annex3.pdf	April 1, 2011
33	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements http://220.227.161.86/18793annex1SA710.pdf	April 1, 2011
34	SA 720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements http://220.227.161.86/15578sa720ann.pdf	April 1, 2010
35	SRE 2400	Engagements to Review Financial Statements http://220.227.161.86/18727annex1200410.pdf	April 1, 2010
36	SRE 2410	Review of Interim Financial Information Performed by the Independent Auditor of the Entity http://220.227.161.86/18728annex2200410.pdf	April 1, 2010
37	SAE 3400	The Examination of Prospective Financial Information http://220.227.161.86/15410Link45_3400SAE-AAS35.pdf	April 1, 2007
38	SRS 4400	Engagements to Perform Agreed Upon Procedures Regarding Financial Information http://220.227.161.86/15411Link46_4400SRS-AAS32.pdf	April 1, 2004
39	SRS 4410	Engagements to Compile Financial Information http://220.227.161.86/15412Link47_4410SRS-AAS31.pdf	April 1, 2004

*Effective date means that the SA is effective for audits of the financial statements for periods beginning on or after the specified date

III. Guidance Notes/Study Guide/Monograph

1. Guidance Note on Audit of Fixed Assets.
2. Guidance Note on Audit of Inventories.
3. Guidance Note on Audit of Debtors, Loans and Advances.
4. Guidance Note on Audit of Investments.
5. Guidance Note on Audit of Miscellaneous Expenditure.
6. Guidance Note on Audit of Cash and Bank Balances.
7. Guidance Note on Audit of Liabilities.
8. Guidance Note on Audit of Revenue.
9. Guidance Note on Audit of Expenses.
10. Guidance Note on Provision for Proposed Dividend

** Text of applicable Guidance notes is available in the Volume II of Paper -2, Auditing and Assurance Study Material. These can be accessed by following the path - http://www.icai.org/post.html?post_id=6192

PAPER – 6 : AUDITING AND ASSURANCE

QUESTIONS

Nature of Auditing

1. Comment on the following statements:

   (a) "Generally an audit is not concerned with the propriety of business conduct".

   (b) "Some material misstatement remains unreported by the auditor."

2. "The audit of financial statements relieves the management or those charged with governance of their responsibilities". Elucidate.

Basic Concepts in Auditing

3. What are audit working papers and why should they be carefully preserved by the Auditor?

4. A senior assistant of A & Co. Chartered Accountants detected a mistake of ₹ 7 per interest payment which have recurred number of times. General Manager (Finance) of R Ltd. suggested him not to request for passing any adjustment entry as individually the errors were of small amounts. The company had 1,500 deposit accounts and interest was paid quarterly.

Preparation for an Audit

5. Medical Council of India organised a three-day International Conference of Doctors in Delhi. You are asked to audit the accounts of the conference. Draft the audit programme for audit of receipt of participation fees from delegates to the conference. Mention any six points, peculiar to the situation, which you will like to include in your audit programme.

6. What are the obvious assertions in the following items appearing in the Financial Statements?

   (a) Profit and Loss Statement

Travelling Expenditure	₹ 50,000

   (b) Balance Sheet

Debtors	₹ 2,00,000

Internal Control

7. (a) An assistant of Ash & Co., Chartered Accountant drew up his audit programme without evaluating internal controls of R Ltd. You, as an Engagement Partner, briefly explain the importance and methods of evaluation of internal control system in his audit program.

   (b) Explain briefly the approaches to EDP auditing?

8. (a) Distinguish between the Internal Control Questionnaire and Internal Control Evaluation.

   (b) You are the internal auditor of AB Manufacturing Co. Ltd. The Managing Director has asked you to inquire into the causes of abnormal wastage of raw materials during the month of September, 2010.

   The wastage percentages are as follows:

June, 2010	1.2%
July, 2010	1.1%
August, 2010	1.3%
September, 2010	3.6%

   How will you proceed to carry out the Assignment?

Vouching &Verification of Assets and Liabilities

9. How will you vouch and/or verify the following ?
   (a) Unclaimed wages
   (b) Retirement gratuity to employees
   (c) Agent's commission
10. Enunciate the General principles of verification of Assets.
11. Write short notes on the following:
   (a) Outstanding Assets.
   (b) Intangible Assets
   (c) Floating Charge
12. How will you vouch and/or verify the following?
   (a) Remuneration to directors.
   (b) Consignment sales.
   (c) Royalties received.

The Company Audit

13. As an auditor, comment on the following situation/statements:
   (a) Travelling expenses of ` 3.25 lakhs shown in Profit and Loss Account of X Ltd., including a sum of ` 2.10 lakhs spent by a Director on his foreign travel for Company's business accompanied by his father for his medical treatment.
   (b) Mr. Rajesh is appointed as the auditor of NOIDA Travels Ltd. with audit fees of ` 35,000. He purchased air ticket from Delhi to Kolkata and back for ` 18,000 from

the client for his personal work and the amount remains unpaid at the end of the year as it is a general practice of the client to give credit to all. Mr. Rajesh claims that he does not incur any disqualification as contained in Section 226(3)(d) of the Companies Act.

14. Give your comments on the following:

(a) Mr. Budha, Statutory Auditors o Directors to attend general meeting general meetings is restricted only him are to be presented and discu

(b) M/s Young & Co., a Chartered A is dissolved on 1.2.2011 due to Board of Directors of Old Ltd. in Sharp & Co. as their new auditors

(c) At an Annual General Meeting, reappointed automatically, as the given to appoint Mr. P, could not b

15. (a) M/s Anand Pvt. Ltd. is incorporat March, 2011, it had issued shares lakhs each from 2 financial institu which is credited to a separate a Report Order, 2003 (CARO) be ap

(b) As the statutory auditor of Bhim would you report on the physica inventory has been conducted by in next year due to lack of time an

16. (a) You are appointed as an auditor the head "Reserves and Surplus"

	Amount ` in lacs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of ` 40 lacs on the same date, which it has disclosed under the head "Profit and Loss Account" on the assets side of the Balance Sheet. Comment.

(b) Write a short note on Disclosure requirements of bank balances of a limited company

Special Audits

17. (a) As an auditor, how will you react to an expenditure incurred by a government department which was sanctioned by a fellow officer of the competent authority as the concerned officer was on leave?

    (b) The assessing officer in order to ensure that there was no loss of revenue, increased the income of all assesses between 50 per cent and 100 per cent. State your view, if you were entrusted to carry out an audit of receipt of the said assessing government department.

18. A Non-Government Organisation (NGO) operating in Delhi had collected large scale donations for Japan Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Japan Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.

Standards on Auditing and Guidance Notes

19. As a statutory auditor, how would you deal with the following?

    (a) The Managing Director of the Company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company.

    (b) The accountant of C Ltd. has requested you, not to send balance confirmations to a particular group of debtors since the said balances are under dispute and the matter is pending in the court.

20. (a) Explain the term "Applicable Financial Reporting framework" in context of the relevant Standard on Auditing.

    (b) "The auditor shall evaluate the requirements of the applicable financial reporting framework". Comment.

SUGGESTED ANSWERS/HINTS

Nature of Auditing

1. (a) Generally an audit is not concerned with the propriety of business conduct

The objective of an audit of financial statements of an enterprise is to enable an auditor to express an opinion as to the truthfulness and fairness of financial statements. The auditor's opinion helps to establish reliability of the financial statements.

The auditors, however, does not give opinion on the propriety of business conduct or its future prospects. SA 200 (revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" has specifically pointed out that the user of the financial statements should not assume that the auditor's opinion is an assurance as to future viability of the enterprise or the efficiency or effectiveness with which the management has conducted the affairs of the enterprise.

In pursuance of the role of the auditor in lending credibility to the financial statements the Companies Act, 1956, has provided that he should be concerned about propriety of some specific transactions.

Section 227(1A) of the Act requires the auditor to enquire into six specified matters and report by exception. This section has been inserted into the Act to ensure that the funds of the company have not been siphoned off by the directors. Also under CARO, 2003 issued by the Central Government in pursuance of powers given to it by Section 227 (4A) of the Companies Act, 1956, the company auditor is required to examine the financial propriety of some transactions.

Further, SA 570, "Going Concern" requires the auditors to evaluate whether the going concern concept is applicable to the circumstances of the entity and whether it will continue for a foreseeable future i.e., a period not exceeding one year after balance sheet. In other words, future viability for one year is to be assessed.

To conclude, we can say that though, generally, an audit is neither concerned with propriety of business conduct nor its future viability yet the auditor would be required to examine the former for the purposes of Section 227(1A) and Section 227(4A) of the Act and the latter for assessing applicability of going concern assumption as per the requirements of SA 570, "Going Concern".

(b) Some material misstatement remains unreported by the auditor

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 results of the enterprise. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The limitations of an audit arise from:

i. The nature of financial reporting;

ii. The nature of audit procedures; and

iii. The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

iv. Other Matters that Affect the Limitations of an Audit

As per SA 200(revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" has emphasized that an auditor cannot be relied upon to discover all the frauds and errors. According to SA 240, "The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements" an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. This implies that some risk of material misstatement could be present in the financial statements and the auditor will fail to detect it.

The Standard has attributed this to inherent limitations of financial audit viz. use of judgment and selective testing by the auditor, inconclusiveness of evidence and limitations of internal control. Similar view is stated in the decision given in London and General Bank case. The auditor is not an insurer. Based on above professional and judicial pronouncements, we can conclude that auditor is not guilty of negligence, if some material misstatements remain undetected despite adopting adequate audit procedures. But the auditor will have civil liability towards client and third parties for negligence if audit has not been performed with reasonable care and skill. Besides this he has criminal liabilities under various sections of the Companies Act, 1956.

2. The audit of financial statements relieves the management or those charged with governance of their responsibilities

As per SA 200(revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", management and, where appropriate, those charged with governance have responsibility:

(a) For the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework; this includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; and

(b) To provide the auditor with:

(i) All information, such as records and documentation, and other matters that are relevant to the preparation and presentation of the financial statements;

(ii) Any additional information that the auditor may request from management and, where appropriate, those charged with governance; and

(iii) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence.

Further, it lays down that the overall objectives of the auditor are:

(1) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(2) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Thus, on the basis of overall objective and scope of the audit of financial statements, as outlined by SA 200(revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", we can conclude that the audit of a financial statement does not relieve the management or those charged with governance of their responsibilities of preparing the financial statements. The auditor's responsibility is limited to performing an audit of the financial statement and expressing an opinion, thereon, through audit report. During the course of audit, the auditors may suggest adjustments to financial statements. However, management or those charged with governance is responsible for all decisions concerning preparation and disclosure in the financial statements.

Basic Concepts in Auditing

3. **Audit Working Papers:** As per SA 230(Revised) "Audit Documentation", Audit Working Papers are the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

Working papers are the

(a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor; and

(b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

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

- Assisting the engagement team to plan and perform the audit.
- 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.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.

- Enabling the conduct of quality control reviews and inspections.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Working papers are the property of the auditor (unless otherwise specified by law or regulation). He may at his discretion, make portions of, or extracts from, working papers available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel

Retention of working papers: Working papers should be retained, long enough, for a period of time sufficient to meet the needs of his practice and satisfy any legal or professional requirement of record retention. Firms are require to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

4. Responsibility of Auditor while detection of mistake

Materiality has been defined by SA 320 "Materiality in Planning and Performing an Audit" as Misstatements, including omissions, if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. In the situation given the error, apparently, seems to be of small amount (` 7) an General Manager (Finance) is of the opinion it is , hence, not material and thus there is no need to pass any adjustment entry. The audit assistant should not accept the argument of the General Manager because there are 1500 deposit accounts and interest payment is quarterly. If the cumulative effect of these small amounts is considered, as per the requirements of SA 320 error of ` 7 which has recurred a number of times may become material. If considered "immaterial" it may cause an overstatement of income. Hence, the auditor should apply expanded substantive procedures to assess the cumulative effect of these small amounts.

Preparation for an Audit

5. Audit of Receipts of Participation Fees

The organization of three-day International Conference of Doctors in Delhi by Medical Council of India is a one-time event. Normally, in view of mega-size of the event, a special cell is made in the organization to handle the entire event. Since few people would be handling the event, the internal controls may not be that strong and, thus, more emphasis is required to be given on substantive procedure. Audit of receipt of participation fees should be under the following areas:

(I) Internal Control System

(i) Examine the organization structure of special cell created for the International Conference, if any, and division of responsibilities amongst persons and control/custody over receipt books.

(ii) Verify the internal control system for restricting the participation of unregistered delegates.

(II) Rate of Participation Fees

(i) Verify with reference to resolution passed by the Organizing Committee/Medical Council of India.

(ii) Also verify the rate from the literature/registration form circulated for promotion of conference.

(III) Receipts of Participation Fees

(i) Verify counter foil of the receipts issued for individual registration.

(ii) Ensure that receipts are issued for all the registration received in cash.

(iii) Trace the receipts in Bank Statement or Cash Book – as the case may be.

(iv) Verify Bank Reconciliation Statement and list out dishonoured cheques.

(v) Verify subsequent recovery in respect of dishonoured cheques.

(IV) Overall Checking

(i) Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants.

(ii) Cross check the total number of delegates with reference to the following:

(a) Kits distributed to participants.

(b) Bill of caterer for providing meals during conference.

(c) Capacity of the Hall.

(d) Participation Certificate if any issued.

(V) Foreign Delegates: In case of foreign delegates – if registration fees are higher – ensure that they are registered at higher fees.

(VI) Special Issues

(i) Take out list of absentees and in case of nil absentees, probe the issue further.

(ii) If certain participants are exempted from payment of fees – obtain the list along with proper authorization in this regard.

6. (a) Travelling expenditure: ` 50,000

(i) **Occurrence:** Travelling expenditure was actually incurred and pertains to the entity during relevant period.

(ii) **Obligation:** Expenditure was actually incurred for the purpose of business.

(iii) **Completeness:** Total amount of expenditure is ` 50,000.

(iv) **Measurement:** It has been treated as revenue item and charged to the profit and loss of the period.

(v) **Presentation and disclosure:** Expenditure is disclosed as per GAAP and relevant statutory requirements, if any.

(b) Debtors: ` 2, 00,000

(i) **Existence:** Debtors exist at the date of balance sheet.

(ii) **Rights:** They represent the total credit sales outstanding on the balance sheet date i.e. are an asset of the entity.

(iii) **Completeness:** There are no unrecorded debtors as on the date of balance sheet

(iv) **Valuation:** Debtors are recorded at proper amount i.e. adequate provision for bad and doubtful debts has been made against them.

Internal Control

7. (a) Review of internal control by the auditor

The examination and evaluation of the internal control system is an indispensable part of the overall audit programme as the auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operations of these internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

The review of internal controls will enable the auditor to know:

(i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;

(ii) whether an adequate internal control system is in use and operating as planned by the management;

(iii) whether an effective internal auditing department is operating;

(iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);

(v) whether the controls adequately safeguard the assets;

(vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;

(vii) how reliable the reports, records and the certificates to the management can be;

(viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;

(ix) what would be appropriate audit technique and the audit procedure in the given circumstances;

(x) what are the areas where control is weak and where it is excessive; and

(xi) whether some worthwhile suggestions can be given to improve the control system.

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.

A review of the internal control can be done by a process of study, examination and evaluation of the control system installed by the management. The first step involves determination of the control and procedures laid down by the management. By reading company manuals, studying organisation charts and flow charts and by making suitable enquiries from the officers and employees, the auditor may ascertain the character, scope and efficacy of the control system. To acquaint himself about how all the accounting information is collected and processed and to learn the nature of controls that makes the information reliable and protect the company's assets, calls for considerable skill and knowledge. In many cases, very little of this information is available in writing; the auditor must ask the right people the right questions if he is to get the information he wants. It would be better if he makes written notes of the relevant information and procedures contained in the manual or ascertained on enquiry.

To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, the auditor can use one of the following to help him to know and assimilate the system and evaluate the same :

(i) Narrative record;

(ii) Check List;

(iii) Questionnaire; and

(iv) Flow chart.

(b) Approaches to EDP Auditing

Computerisation of accounts does not affect the basic objective of auditing. However, the auditor would need to modify his audit procedures, approach and technical capabilities so as to be able to form an opinion on the accounts processed in a computerised environment. The auditor must plan whether or not to use the computer. The two approaches are commonly called "auditing around the computer" and "auditing through the computer".

Audit around the Computer: Audit around the computer involves forming of an audit opinion wherein the existence of computer is not taken into account. Rather the principle of conventional audit like examination of internal controls and substantive testing is done. The auditor views the computer as a black box, as the application system processing is not examined directly. The main advantage of auditing around the computer is its simplicity. Audit around the computer is applicable in the following situations:

(i) The system is simple and uses generalised software that is well tested and widely used.

(ii) Processing mainly consists of sorting the input data and updating the master file in sequence.

(iii) Audit trail is clear. Detailed reports are prepared at key processing points within the system.

(iv) Control over input transactions can be maintained through normal methods, i.e. separation of duties, and management supervision.

Generalised software packages, like payroll and provident fund package, accounts receivable and payable package, etc. are available, developed by software vendors. Though the auditor may decide not to go in details of the processing aspects, if there are well tested widely used packages provided by a reputed vendor. However, he has to ensure that there are adequate controls to prevent unauthorised modifications of the package. However, it may be noted that all such generalised packages do not make the system amenable to audit. Some software packages provide generalised functions that still must be selected and combined to achieve the required application system. In such a case, instead of simply examining the systems input and output, the auditor must check the system in depth to satisfy him about such system. The main disadvantages of the system of auditing around the computer are:

(1) It is not beneficial for complex systems of large scale in very large multi unit, multi locational companies, having various inter unit transactions. It can be

used only in case of small organisations having simple operations.

(2) It is difficult for the auditor to assess the degradation in the system in case of change in environment, and whether the system can cope with a changed environment

Audit through the Computer: The sophistication of computers have finally reached the point where auditors can no longer audit around the system. They are forced to treat the computers as the target of the audit and audit through it. Auditing through the computer requires that the auditor submits data to the computer for processing. The results are then analysed for the processing reliability and accuracy of the computer programme. Technical and other developments that necessitated this approach include the following:

- On-line data entry.
- Elimination or reduction of print-outs.
- Real time files up dating.

The auditor can use the computer to test:

(i) the logic and controls existing within the system; and

(ii) the records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor.

There are several circumstances where auditing through the computer must be used:

(1) The application system processes large volumes of input and produces large volumes of output that make extensive direct examination of the validity of input and output difficult.

(2) Significant parts of the internal control system are embodied in the computer system. For example, in an online banking system a computer programme may batch transactions for individual tellers to provide control totals for reconciliation at the end of the day's processing.

(3) The logic of the system is complex and there are large portions that facilitate use of the system or efficient processing.

(4) There are substantial gaps in the visible audit trail.

The primary advantage of this approach is that the auditor has increased power to effectively test a computer system. The range and capability of tests that can be performed increases and the auditor acquires greater confidence that data processing is correct. By examining the system's processing, the auditor also can assess the system's ability to cope with environment change.

The primary disadvantages of the approach are generally high costs and the need for extensive technical expertise when systems are complex. However, these disadvantages are really not that important if auditing through the computer is the only viable method of carrying out the audit.

Auditing through computer may be conducted through test data, computer programme, etc.

8. (a) Internal Control Questionnaire (ICQ) and Internal Control Evaluation (ICE)

The internal control questionnaires show the area where weakness occur or likely to occur. They do not give any idea of the importance of those weaknesses. The Internal Control Evaluation brings to light importance of those weakness disclosed by ICQ.

Main points of distinctions are:

(i) ICQ incorporates a large number of detailed questions but does not attempt to distinguish their relation in materiality. ICE isolates the main control objectives within the area of review.

(ii) Weaknesses are highlighted by answer "Yes" on ICE compared with 'No' on ICQ.

(iii) Answer 'no' in ICQ indicates a weakness real or potential, but its significance is not revealed. Whereas ICE requires audit personnel to state whether, an apparent weakness may prove to be material in relation to the accounts as a whole.

(iv) The 'Control Checklist' in ICE is more than a summary of key control factors, and is no substitute for ICQ.

(b) Abnormal Wastage of Raw Material

The rate of wastage in September, 2010 has risen sharply as compared to previous months. Under the circumstances, before setting for detailed investigation, the internal auditor need to understand the manufacturing environment right from the stage of purchase of materials, the movement of stock flow through the production process while its becomes finished goods. To locate the reasons for the abnormal wastage, the internal auditor should first of all assess the general requirements as under:

(i) Procure a list of raw materials, showing the names and detailed characteristics of each raw material.

(ii) Obtain the standard consumption figures, and ascertain the basis according to which normal wastage figures have been worked out. Examine the break up of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.

(iii) Examine the various records maintained for recording separately the various lots purchased and identification of each lot with actual material consumption and for ascertaining actual wastage figures therein.

(iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrap page work.

(v) Assess whether personnel employed are properly trained and working efficiently.

(vi) See whether quality control techniques have been consistent or have undergone any change.

(vii) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.

(viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months.

(ix) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

Some specific reasons for abnormal wastage in process specific may be considered by the auditor are as under:

(1) Examine laboratory reports and inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.

(2) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.

(3) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors' reports in respect of inspection carried out on the completion of each stage of work or process.

(4) It is possible that the wastage may have occurred because the particular lot out of which issues were made in September, 2010 was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures of September, 2009 with those of September, 2010.

(5) Abnormal wastage in storage and handling may arise due to the following reasons:

(i) *Write offs on account of reconciliation of physical and book stocks*: In case of periodical physical stock taking, such write offs will be reflected only in the month such reconciliation takes place.

(ii) *Accidental, theft or fire losses in storage*: The auditor should examine the possibility of these for the purpose.

(6) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.

Vouching and Verification of Assets and Liabilities

9. (a) Unclaimed wages

(i) In the case of unclaimed wages, a schedule is generally prepared by the client's staff showing the names of workers, the amount due and the period covered. The auditor should examine such a schedule and ensure that the said amount has been deposited into a bank in a separate account by referring to counterfoil of pay-in-slip

(ii) In organizations where unclaimed wages are deposited with the main cashier, the auditor should vouch such deposit with an acknowledgement letter duly signed by cashier.

(iii) Subsequent payment out of unclaimed wages should be verified with referenced to separate vouchers which should also be signed by the head of department to which the employee belongs or by concerned supervisor. Such signatures are necessary to certify proper identification of the employee.

(b) Retirement gratuity to employees

(i) Examine the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or agreement or on the presumption that all employees retire on the balance sheet date.

(ii) Ensure that the basis of computing gratuity is valid.

(iii) Verify computation of liability of gratuity on the aggregate basis.

(iv) Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them.

(v) See that the annual premium has been charged to Profit and Loss Account in case the concern has taken a policy from LIC.

(vi) Ensure that the accounting treatment is in accordance with AS-15 (Revised), "Retirement Benefits".

(c) Agent's commission

(i) The payment to agent for his commission is checked with reference to commission account, sales report sent by him and agreement between the client and the agent for details such as rate of commission and other terms and conditions.

(ii) The auditor should check the relevant calculations himself and trace such payments to bank statements.

10. General principles of verification of Assets

It is not sufficient for the auditors only to verify correctness of the amount of assets shown in the balance sheet, he must verify them by actual inspection or otherwise and establish the existence of assets.

Points requiring auditor's attention for verification are as under:

(i) **Cost** - In regard to assets, verification procedure need not generally be extended to determination of the correctness of costs and authority to incur costs unless the items concerned were purchased during the accounting period under review. In such cases the auditor should check the correctness of costs through normal vouching method. He should ensure that adequate distinction has been made between 'revenue' and 'capital' nature of costs.

(ii) **Ownership** – Where ownership of assets is evidenced by documents of title etc. as in the case of immovable property, a reference should be made to such documents. If the documents are held by third person the auditor should either obtain a certificate directly from that party or arrange to inspect them at the third party's place of business.

(iii) **Valuation** - It must be ascertained that all assets are valued in accordance with appropriate accounting policy. For the valuation made, the basis must be consistently applied, unless circumstances necessitated a change. Even then a disclosure is required for the change and its monetary effect.

(iv) **Existence** – Physical inspection should be done wherever possible. Where physical inspection is not possible, the possibility of obtaining indirect evidence be considered e.g. machinery imported held in customs godown or materials sent to subcontractor for job work or fabrication. In such circumstances certificating of such parties should be obtained and if considered necessary even physical verification may be requested.

(v) **Presentation in accounts** - Material assets must be properly disclosed and correctly described in the accounts. It should be seen that the description given to them is clear and complete and is not misleading e.g. stating loans on the assets side of the balance sheet "as dependent upon realization" is just misleading as was held in the case of London and General Bank Ltd. care must be taken to see that disclosures required under the statute or statement issued by ICAI are complied with.

11. (a) Outstanding Assets

It is a well accepted accounting principle that all expenditure pertaining to the year alone should be charged against year's revenue and all income whether received or not should be accrued for the year. Following this principle one has to make certain year end adjustments in the books of account and outstanding assets are brought to book in that process. If expenditure has been made on certain revenue heads, the benefit of which is to be derived even after the year is over and adjustment is made to the original figure of expenditure so as to carry forward the sum that does not pertain to the year an outstanding asset is created. Similarly, if certain income has accrued for the year but has not been received, the amount that has so accrued is usually brought into books as year end adjustment and thereby creating an outstanding assets account.

Generally, outstanding assets are those items for which amounts are yet to be received though services, etc. have been rendered, or items for which benefit of service will be received later. For example, in case insurance amount has been paid in advance then the proportion thereof applicable to the period subsequent to the date of the balance sheet should be calculated and shown as an outstanding assets. Other examples of outstanding assets may include rent receivable, commission receivable, advertising amount paid in advance, interest receivable on loans, etc.

(b) Intangible Assets

An intangible asset is that asset which does not have a physical identity but which is used by the enterprise for production or supply of goods or for retails to other or for administrative purpose. Such asset does not have any physical existence but their presence in the business is indicated with a value placed thereon. These assets include rights and benefit to owners subject to their being useful. For example: goodwill, patents, copyright etc. AS 26, "Intangible Assets", applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it. This standard also applies to rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. An intangible asset should measured at cost. After initial recognition an intangible asset should be carried at its cost less any accumulated amortisation and any impairment losses.

Auditor should also ensure that proper disclosure is made in the financial statements about the carrying amount, amortisation methods, useful lives, etc.

(c) Floating Charge

Floating charge refers to a general charge on some or all the assets of an enterprise which is not attached to any specific assets and is given as a security against a debt. It has the effect of creating an immediate charge on the property of the company leaving the company to deal with the same in the ordinary course of business, but subject to the limitations imposed in the instrument of creating the charge. The floating charge, however, becomes fixed or crystallised and the creditor becomes entitled to proceed against the assets on which the charge was created, on violation of any of the terms of the instruments creating the charge. This charge is also required to be registered within 30 days of its creation under section 125 of the Companies Act, 1956.

12. (a) Remuneration paid to Directors

(i) Refer to General Meeting or Board meeting resolution for the appointment and terms of appointment of the directors.

(ii) Examine Articles of Association and general meeting resolution to determine the mode of payment-monthly, quarterly, or by way of commission.

(iii) Check agreement with the director.

(iv) Verify director's attendance in the board meetings.

(v) Ensure compliance with the provisions of Sections 198, 309, 349 and 350 and Schedule XIII of the Companies Act, 1956, where appropriate.

(vi) Check computation of the net profits and the commission payable to directors in terms of clause 4A of Part II of Schedule VI to the Companies Act, 1956.

(b) Consignment Sales

(i) Ascertain that credit has been taken only for the profit on the goods sold through the consignee before the year end. No profit should be taken for the profit on goods remaining in the hands of the consignee.

(ii) Verify credits in the Consignment Account with the help of the Account Sales received from the consignee. The gross sale proceeds should be credited to the Consignment Account and debited to the consignee's account.

(iii) Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the Consignment Account and credited to the Consignee's A/c. The Account Sales also must be correspondingly checked.

(iv) Ensure that the stock lying with the consignee at the end should be taken in the balance sheet at cost on a consistent basis and credited to the Consignment A/c to arrive at the result of the consignment transactions.

(v) Obtain confirmation of the balance in the account of the consignee from the consignee.

(vi) Sometimes, the goods are consigned not at cost but at an inflated price. The auditor should see that the necessary adjustments to remove the loading are made at the end of the year.

(vii) Ensure that the goods consigned are not treated as ordinary sales. In cases it is so, the auditor should see that necessary adjustments are made at the year end in respect of the unsold goods, commission and the expense incurred by consignee. The consignee should not be shown as a debtor for unsold goods and in valuation of stock, these goods should be included in stock at cost worked out on a consistent basis.

(c) Royalties Received

(i) Verify the relevant contract and ascertain the provisions relating to the conditions of royalty such as rate, mode of calculation and due date.

(ii) Check the periodical statement received in respect of books printed, sold and stock lying at different locations..

(iii) Check the computation in the royalty statement and ensure that any deduction or adjustment made from the royalty due is as per agreement conditions.

(iv) Verify the provisions for the royalty to be received as at the end of the year.

The Company Audit – I

13 (a) Reimbursement of personal expense of Director

All payments to Directors as remuneration or perquisites whether in the case of a public or private company are required to be authorised both in accordance with the Companies Act and Articles of Association of the company. Articles may provide that such remuneration require sanction of the shareholders either by ordinary or special resolution while in some cases it may require only approval of Directors. If the terms of appointment of a Director include payment of expenses of a personal nature, then such expenses can be incurred by the company; otherwise, no such expense can be incurred or reimbursed by the company.

The auditor has to ensure that if such expenses are paid, he has to disclose the fact in his report, as also in the accounts. In this regard attention is invited to section 227 (1A) (e) of the Companies Act wherein auditor has to inquire into whether personal expenses have been charged to revenue. However, reporting requirements "the requirement of identifying and reposting on personal expenses" has been dispensed with in CARO, 2003.

In the given situation, the auditor should vouch travelling expenses in the usual manner. If the director has spent entire time for company's business, the amount of

` 2.10 lakhs spent by him on foreign travel should be charged to the revenue of the company. If the director has, along with attending the company's business, spent time on medical treatment of his father, then the auditor should suggest a reasonable basis to allocate a part of ` 2.10 lakhs to be charged to the profit and loss account of the company and the rest to the treated as personal expenses.

(b) Disqualification of auditors

The guidance note on "Independence of Auditors" issued by the ICAI in this context recommends that "a question of indebtedness may also be raised where an auditor of a company purchases goods or services from the company audited by him. In such a case, if the amount outstanding exceeds ` 1000, irrespective of the nature of the purchase or period of credit allowed to other customers, the provisions concerning disqualification of auditor as contained in section 226 (3) (d) will be attracted." This is applicable in the case of purchase of air tickets for personal work by the auditor of a company on normal terms and conditions of the business of the company as the amount outstanding at the end of the year exceeded ` 1000. Therefore, the contention of Mr. Rajesh that he does not incur disqualification is not correct as he has purchased a ticket of the value of ` 18,000. The provisions concerning disqualifications of auditor as contained in section 226 (3) (d) will be attracted.

14. (a) Right to attend the Meeting

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

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

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

(b) Casual Vacancy

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

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

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

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

(c) Reappointment of Retiring Auditor

Section 224(2) of the Companies Act, 1956 dealing with reappointment of auditors specifies that subject to the provisions of sub-section (1B) and section 224A, at any Annual General Meeting a retiring auditor, by whatsoever authority appointed, shall be re-appointed unless, *inter alia*:

"Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or dis-qualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with."

However, it should be noted that even for the re-appointment of a retiring auditor, the passing of a resolution is essential. Section 224 of the Companies Act, 1956, requires that a resolution has to be passed by the company every year. In the absence of a resolution, the retiring auditor is not re-appointed automatically.

Thus, the claim of Mr R would not hold good.

The Company Audit – II

15 (a) Applicability of CARO, 2003

The Companies (Auditor's Report) Order (CARO), 2003, exempts private limited companies from its application which fulfils all the following conditions:

(i) the paid up capital and reserves are ` 50 lakhs or less;

(ii) it has not accepted any public deposits;

(iii) it has no outstanding loan of ` 10 lakhs or more from any bank or financial institution; and

(iv) its turnover does not exceed ` 5 crores.

In the case of M/s Anand Pvt. Ltd., its paid-up capital is less than ` 50 lakhs, turnover is less than ` 5 crores since excise duty is not taken into account if it is credited separately to excise duty account; and, it is also implied from the facts that it has not accepted any public deposits. However, it fails to fulfill the condition relating to outstanding loan because as per the statement on CARO, 2003, issued by the Institute, requires that the amount of outstanding loan taken from bank/financial institution have to be considered on a cumulative basis. M/s Anand

Pvt. Ltd. has total borrowings of ` 15 lakhs and thus fails to satisfy all conditions and accordingly CARO, 2003 will be applicable.

(b) Physical verification of inventory

Para 4(ii)(a) of CARO, 2003 requires the auditor to state in his report whether physical verification of inventory has been conducted at reasonable interval by the management. Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification. In the given case, the above requirement of CARO, 2003 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

16. (a) Debit Balance of Profit and Loss Account

Part I of Schedule VI to the Companies Act, 1956 requires that the debit balance of Profit and Loss Account shall be shown as deduction from the uncommitted reserves, if any. Hence, the accumulated loss of ` 40 lakhs should be deducted from the General Reserve of ` 90 lakhs, and the net amount of ` 50 lakhs should be shown as General Reserve on the Liabilities side of the Balance Sheet. Securities Premium Account and Capital Reserves are not uncommitted reserves and, thus, these shall also be shown on the liabilities side of the balance sheet under the heading of “Reserves and Surplus”. In the present case, the disclosure requirements of Schedule VI to the Act have not been followed and, accordingly, the auditor should modify his report.

(b) Disclosure Requirements for Bank Balance

As per Part I of Schedule VI to the Companies Act, 1956, the disclosure requirements for bank balance were as under:

(i) Bank balance with scheduled bank.

(ii) Bank balance with banks other than scheduled banks.

The other particulars are to be stated are as under:

(1) Balances lying with scheduled banks in current accounts, call accounts, deposit accounts.

(2) Where the balance is with non-scheduled bank, the name of the banker, balances lying with such bankers on current accounts, call accounts and deposit accounts, the maximum amount outstanding with them during the year should be specified.

(3) the nature of the interest, if any, of any director or his relative [or the managing agent/secretaries and treasurers of any associate of the latter] in each of the bankers (other than Scheduled Banks) referred to in (b) above.]

Special Audits

17. (a) Audit of Sanctions

The auditor has to ensure that each item of the government expenditure is covered either by general or special sanction of the competent authority. The audit of sanction is directed both in respect of ensuring that the expenditure is properly covered by sanction and the authority sanctioning is competent for the purpose by virtue of the powers vested in it by the provisions of the constitution and of the laws, rules or orders made there-under, or by the rules of delegation of financial powers made by the authority competent to do so. Accordingly, if the concerned officer has not delegated the financial authority to the fellow officer, the sanction of expenditure should be considered as improper. Hence the auditor should mention the fact in his report.

(b) Audit of Receipts

Audit of receipts provides for ensuring whether debts due to government have been correctly evaluated, assessed, realized and credited to government account by the designated authorities. The main emphasis is on examining the procedure regarding the refund of all revenue receipts. The basic principle of audit of receipts is that it is more important to look at the general than on particular individual cases of assessment, demand, collection and refund. A review of the judicial decisions taken by tax authorities is also done to judge the effectiveness of the assessment procedure. Amongst evaluation of procedure, the auditor shall be expected to follow up of claims on tax payers and exercise due diligence. It is but normal that the claim should not be abandoned or reduced except with adequate justification and proper authority. Flowing from the above, the action of assessing officer is unjustifiable since it is arbitrary and violates the principle of natural justice as well.

18. (i) Receipt of Donations

(1) Internal Control System: Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.

(2) Custody of Receipt Books: Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.

(3) Receipt of Cheques: Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.

(4) Bank Reconciliation: Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.

(5) Cash Receipts: Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.

(6) Foreign Contributions, if any, to receive special attention to compliance with applicable laws and regulations.

(ii) Remittance of donations to different NGOs

(1) Mode of Sending Remittance: All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.

(2) Confirming Receipt of Remittance: All remittances are supported by receipts and acknowledgements.

(3) Identity: Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.

(4) Direct Confirmation Procedure: Send confirmation letters to entities to whom donations have been paid.

(5) Donation Utilisation: Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.

(6) System of NGOs' Selection: System for selecting NGO to whom donations have been sent.

Standards on Auditing and Guidance Notes

19. (a) Fraud Committed by Managing Director

The Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements". First of all, as per SA 240, the auditor needs to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment. Secondly, the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. Thirdly, the auditor should communicate the matter to the Chairman and Board of Directors. Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management. Finally, the auditor shall have to report under CARO, 2003 indicating the nature and amount involved in respect of fraud noticed during the year.

(b) External confirmation Requests

SA 505, "External Confirmations", establishes standards on the debtor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management.

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

(i) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;

(ii) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and

(iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260 (Revised), "Communication with Those Charged with Governance". The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

20. (a) Applicable financial reporting framework

As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.

(b) Evaluation of the requirements if the applicable financial reporting framework

As per SA 700, "Forming an Opinion and Reporting on Financial Statements", the auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:

(i) The financial statements adequately disclose the significant accounting policies selected and applied;

(ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

(iii) The accounting estimates made by management are reasonable;

(iv) The information presented in the financial statements is relevant, reliable, comparable and understandable;

(v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and

(vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

ANNEXURE

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR NOVEMBER, 2011 EXAMINATION

The following List of Institute's Publications is relevant for the forthcoming examination i.e. November, 2011. Students may kindly take it into consideration while preparing for the examination.

Professional Competence Course
Paper 2 : Auditing and Assurance

I. Statements

1. Statement on Reporting under Section 227 (1A) of the Companies Act, 1956
   http://220.227.161.86/18799announ10264b.pdf
2. Statement on the Companies (Auditor's Report) Order, 2003 (2005 Edition)
   http://220.227.161.86/18798announ10264a.pdf

II. Standards on Auditing (SAs)

S.No	SA	Title of Standard on Auditing	Effective Date
1	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing http://220.227.161.86/18132sa200_rev.pdf	April 1, 2010
2	SA 210	Agreeing the Terms of Audit Engagements http://220.227.161.86/16837sa210revised.pdf	April 1, 2010
3	SA 220	Quality Control for an Audit of Financial Statements http://220.227.161.86/18133sa220_rev.pdf	April 1, 2010
4	SA 230	Audit Documentation http://220.227.161.86/15372Link7_SA230-standard.pdf	April 1, 2009
5	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements http://220.227.161.86/15374Link9_240SA_REVISED.pdf	April 1, 2009
6	SA 250	Consideration of Laws and Regulations in An Audit of Financial Statements http://220.227.161.86/15376Link11_SA250-text.pdf	April 1, 2009
7	SA 260	Communication with Those Charged with Governance http://220.227.161.86/15378Link13_SA%20260-text.pdf	April 1, 2009
8	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management http://220.227.161.86/16838sa265.pdf	April 1, 2010
9	SA 299	Responsibility of Joint Auditors http://220.227.161.86/15379Link14_299SA-AAS12.pdf	April 1, 1996

10	SA 300	Planning an Audit of Financial Statements http://220.227.161.86/15381Link16_300SA_REVISED.pdf	April 1, 2008
11	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment http://220.227.161.86/15382Link17_315SA.pdf	April 1, 2008
12	SA 320	Materiality in Planning and Performing an Audit http://220.227.161.86/16839sa320revised.pdf	April 1, 2010
13	SA 330	The Auditor's Responses to Assessed Risks http://220.227.161.86/15384Link19_330SA.pdf	April 1, 2008
14	SA 402	Audit Considerations Relating to an Entity Using a Service Organization http://220.227.161.86/16840sa402revised.pdf	April 1, 2010
15	SA 450	Evaluation of Misstatements Identified during the Audits http://220.227.161.86/16841sa450revised.pdf	April 1, 2010
16	SA 500	Audit Evidence http://icai.org/resource_file/15576sa500revised.pdf	April 1, 2009
17	SA 501	Audit Evidence - Specific Considerations for Selected Items http://220.227.161.86/18134sa501_rev.pdf	April 1, 2010
18	SA 505	External Confirmations http://220.227.161.86/18135sa505_rev.pdf	April 1, 2010
19	SA 510	Initial Audit Engagements-Opening Balances http://220.227.161.86/15390Link25_510text.pdf	April 1, 2010
20	SA 520	Analytical Procedures http://220.227.161.86/18136sa520_rev.pdf	April 1, 2010
21	SA 530	Audit Sampling http://220.227.161.86/15393Link28_530text.pdf	April 1, 2009
22	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures http://220.227.161.86/15395Link30_540text.pdf	April 1, 2009
23	SA 550	Related Parties http://220.227.161.86/15397Link32_550text.pdf	April 1, 2010
24	SA 560	Subsequent Events http://220.227.161.86/15399Link34_SA%20560_Standard_OK OK.pdf	April 1, 2009
25	SA 570	Going Concern http://220.227.161.86/15401Link36_SA570-final_standard.pdf	April 1, 2009
26	SA 580	Written Representations http://220.227.161.86/15403Link38_sa580.pdf	April 1, 2009
27	SA 600	Using the Work of Another Auditor http://220.227.161.86/18836sa600_aas.pdf	April 1, 2002
28	SA 610	Using the Work of Internal Auditors http://220.227.161.86/16842sa610revised.pdf	April 1, 2010

29	SA 620	Using the Work of an Auditor's Expert http://220.227.161.86/18137sa620_rev.pdf	April1, 2010
30	SA 700	Forming an Opinion and Reporting on Financial Statements http://220.227.161.86/17874sa700annx1.pdf	April 1, 2011
31	SA 705	Modifications to the Opinion in the Independent Auditor's Report http://220.227.161.86/17875sa705annex2.pdf	April 1, 2011
32	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report http://220.227.161.86/17876sa706annex3.pdf	April 1, 2011
33	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements http://220.227.161.86/18793annex1SA710.pdf	April 1, 2011
34	SA 720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements http://220.227.161.86/15578sa720ann.pdf	April 1, 2010
35	SRE 2400	Engagements to Review Financial Statements http://220.227.161.86/18727annex1200410.pdf	April 1, 2010
36	SRE 2410	Review of Interim Financial Information Performed by the Independent Auditor of the Entity http://220.227.161.86/18728annex2200410.pdf	April 1, 2010
37	SAE 3400	The Examination of Prospective Financial Information http://220.227.161.86/15410Link45_3400SAE-AAS35.pdf	April 1, 2007
38	SRS 4400	Engagements to Perform Agreed Upon Procedures Regarding Financial Information http://220.227.161.86/15411Link46_4400SRS-AAS32.pdf	April 1, 2004
39	SRS 4410	Engagements to Compile Financial Information http://220.227.161.86/15412Link47_4410SRS-AAS31.pdf	April 1, 2004

*Effective date means that the SA is effective for audits of the financial statements for periods beginning on or after the specified date

III. Guidance Notes/Study Guide/Monograph

1. Guidance Note on Audit of Inventories.
2. Guidance Note on Audit of Debtors, Loans and Advances.
3. Guidance Note on Audit of Investments.
4. Guidance Note on Audit of Miscellaneous Expenditure.
5. Guidance Note on Audit of Cash and Bank Balances.
6. Guidance Note on Audit of Liabilities.
7. Guidance Note on Audit of Revenue.
8. Guidance Note on Audit of Expenses.
9. Guidance Note on Provision for Proposed Dividend

** Text of applicable Guidance notes is available in the Volume II of Paper -2, Auditing and Assurance Study Material.