Q.1) Type of markets under NEAT

- NEAT stands for **National Exchange for Automated trading system**. It is a fully computerized screen based trading system.
- It enables members from across the country to trade simultaneously with ease and efficiency by keying their orders into system.

1. (i) **Normal Market**: All orders of regular lot size or multiples thereof are traded in the normal market. Normal market consists of regular lot orders, special term orders, negotiated trade order and stop loss order depending on their order tributes.
2. (ii) **Odd Lot Market**: If the order size is less than the regular lot size such orders are traded in the odd lot market. In an odd lot market both the price and quantity of both the orders (buy and sell) should exactly match for the trade to take place.
3. (iii) **Spot Market**: Spot orders are similar to normal market orders except that spot orders have different settlement periods vis-a-vis normal market.
4. (iv) **Auction Market**: In the auction market, auctions are initiated by the exchange on behalf of trading members, for completing the settlement process.

Q.2) Circuit Filters

- Circuit filters or Circuit Breakers are the price bands that set the upper and lower limit within which a stock can fluctuate on any particular day.
- A price band for a day is a function of previous trading day's closing.
- SEBI has directed the exchanges to apply circuit filters on scrips traded in rolling settlement if their prices fluctuates more than 20% of closing price of scrip on previous day in any direction.
- However, for scrips forming part of sensex or in which derivatives and futures are available, the fluctuation is restricted to 10%.

Q.3)Rolling Settlement:

- A rolling settlement is one in which a transaction outstanding at the end of the day have to be settled within X number of business days from the transaction date.
- If a transaction is entered on Monday on T+2 rolling settlement, it will be settled on Wednesday when pay in or payout take place.
- The pay in and pay out of funds are effected on the same specified date.
- SEBI has mandated most of the scrips to be settled exclusively on rolling settlement basis.

Q.4) Hit or Take Orders:

- Hit or take orders occur in screen-based trading in stock exchange. This is a variation of market orders.
- It enables faster order execution without disturbing the limit order book.
- This method converts the key strokes or mouse clicks of the broker into a limit order at the touch line price for a particular scrip, without his having to place a limit order.
- Further all unexecuted orders of this type are automatically killed and are therefore not stored in the order book.

Q.5) Contract Notes:

1. Contract note is a document through which a contractual obligation is established between a member and a client.
2. It is a document with the complete description of a stock transaction.
3. Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf.

Member's Duties :

1. Should issue Contract Notes within 24 hours.
2. Should be prepared in the form prescribed by Stock Exchange.
3. Should preserve the counterfoils or duplicates.
4. Brokerage should be separately stated.

Auditor's Duties :

1. Evaluate Internal control procedure for proper maintenance and issue of Contract Notes.
2. Ensure that contract notes are serially numbered and not left blank.
3. Verify that the format is as prescribed by the regulations on the exchange.
4. Examine whether issued within 24 hrs.
5. Examine whether signed by Authorized person.
6. Ensure whether Brokerage, Service Tax and STT are separately stated.

Q.6) Sauda Book:

- It is the chronological record of all transactions entered into by a member on day to day basis.
- Sauda Book contains the following details
  - Name of the Client
  - Code No of the Client
  - Securities Bought/Sold on behalf of the Client
  - Rate and Qty of Securities Bought/Sold
- Following records are recoeded in the Transaction Register
  - member's own business on the Exchange,
  - member's business on client's behalf,
  - member's business with the clients
  - Spot transactions etc.

Q.7) Margins:

- Margin refers to compulsory deposit made by members with the stock exchange authorities.
- This mechanism is adopted in order to
  - ✓ Restrict excessive speculation
  - ✓ Safeguard interest of investors

Types of Margins :

1. **Gross Exposure Margin :**
   - GEM is computed on the aggregate of the net cumulative outstanding positions (purchases or sales) in each security.
   - Each stock exchange determines its own rates of GEM based on risk perception.
2. **Mark to Market Margin :**
   - This margin is imposed to cover a loss that a member may incur.
   - It is the notional loss that is incurred in case the transaction is closed out at a closing price different from a price at which the transaction has been entered.
3. **Volatility Margin :**
   - It is levied to curb the excessive volatility in securities.
   - It is also used to prevent the building up of excessive outstanding positions.
   - This margin is calculated at the discretion of the stock exchange to charge margin on a particular security, on specific percentage.

Q.8) Carry Forward System

- Refers to the trading in which settlement is postponed to the next accounting period.
- Members are classified as Type-I and Type-II members. Only Type-I members are allowed to carry forward their position.
- Scrips chosen for carry forward should have sufficient floating stock and high liquidity

Q.9) Advantages of Cost Audit

1. To the Management

- Reliability of data for day to day operations.
- Continuous check on all wastages.
- Highlighting of inefficiencies in operations.
- Detection and prevention of frauds and errors.
- Reliable check on valuation of Closing Stock.

2. To the Society

- Proper pricing saves consumer from exploitation.
- Consumer can maintain standard of living since price increase in not allowed without proper justification.

3. To the Shareholders

- Cost Audit ensures proper records are kept for purchases, utilization of materials, etc.
- Ensures economic and efficient run of enterprise.
- Fair Return On Investment is determined by proper determination of Cost.

4. To the Government

- Fixation of Cost plus contracts, wherever applicable.
- Focus attention on inefficient units.
- Settlement of trade disputes.
- Promoting healthy competition among industries.
- Protection to certain industries based on their needs.

Q.10) Reconciliation of Cost and Financial Records

- These are reconciled to ensure adequacy
- Any variations should be clearly indicated and explained
- Period of reconciliation should not be more than the financial year of the Co.
- Reconciliation should indicate effect on the profitability of the product and overall profits of the Co.
- Difference between Sales Realization and Total Cost is ascertained and then it is reconciled with the financial P & L A/c of the Co.

Q.11) Why Cost Auditor refers to Financial Records

- Cost Audit Programme encompasses the regular Financial Audit procedures like Vouching of Expenses, Verification of Assets and Liabilities, etc. Hence, financial records should also be seen.
- Verification of the Reconciliation Statement calls for a reference to the financial records.
- Co. has to disclose the quantitative details of raw materials used, actual production, finished goods sold, etc. These are common to both financial and cost records. Hence the Cost Auditor has to refer financial records.
- Comparision between Cost and Financial records may throw up the need for inquiry into errors, mistakes and manipulations.

Q.12) True and Fair Cost of Production:

- The Cost Auditor is required to express his opinion on true and fair cost.
- The Cost is said to be True and Fair if :
  1. Accepted Cost Accounting Principles have been applied.
  2. Such Principles are applied on Consistent basis.
  3. Costing System appropriate to the product is used.
  4. All Material items are considered.
  5. Elimination of prior period adjustments in the Cost Sheet.
  6. Abnormal Losses are ignored.

Q.13) Propriety Elements in Cost Audit Report

1. The Cost Auditor shall report on ------
   - Matters which appear to him to be clearly wrong in principle or apparently unjustifiable
   - Cases where the Co's funds have been utilized in negligent or inefficient manner
   - Factors which could have been controlled but have not been done so resulting in increasing Cost of Production

2. The Cost Auditor shall suggest measures for improvements in performance in respect of ------
   - Rectification of general imbalances in production facilities
   - Fuller utilization of capacity
   - Concentration on areas offering scope for cost reduction, increased productivity, etc.

3. The Cost Auditor may give his other Observations and Conclusions, if any, relevant to Cost Audit.

Q.14) Merging of Cost and Financial Audit is not possible. Reasons

1. It is difficult to collect the accounting information in a single format for Cost and Financial Audit purposes.
2. The Objective of Financial Audit is to express an opinion on truth and fairness of Financial Statements whereas the objective of Cost Audit is to verify the accuracy of Cost records.
3. Financial Accounts present data under different accounting heads whereas Cost Records present information on product lines and cost centres.
4. Financial Audit Report is too general and made public as per the requirements of Companies Act whereas Cost Audit Report may contain certain information which may be Confidential.
5. Cost Audit focuses on review of information on each cost element in detail. Hence, focus and review is much different from that of Financial Audit.

Q.15) Steps in Investigation

1) Determine the Objectives and establish the Scope of Investigation
2) Formulate an Investigation Programme depending on the specific circumstances.
3) Examine / Study various records and collect appropriate evidence.
4) Analyse, process and interpret the findings of the analysis.
5) Draw up conclusion and prepare the Investigation Report

Q.16) Aspects in Cost Audit Programme

- ✓ Size of the Firm
- ✓ Purpose and Frequency of Cost Audit
- ✓ Areas of Coverage and Volume of Transactions
- ✓ Range of products and production process
- ✓ Existence of efficient Costing System and Dept
- ✓ Existence of efficient Internal Audit Dept
- ✓ Cost Accounting System, procedures and Documentation

Q.17) Solvency Margin

- Every Insurer should maintain an excess of the value of its assets over the amount of its liabilities at all times.
- This is called as Solvency Margin as per the Insurance Act.
- As per the Irda (Assets, Liabilities, and Solvency Margin of Insurers) Rules 2000, both life and general insurance companies need to maintain solvency margins.

<u>Computation of Solvency Margin</u>

Highest of the following –

a) Rs.50 Crores (Rs.100 Crores in case of Re-Insurer)
b) 20% of Net Premium Income
c) 30% of Net Incurred Claims

Q.18) Differentiate between Cost Audit and Financial Audit

BASIS	FINANCIAL AUDIT	COST AUDIT
Coverage	• Covers Financial trans-actions and procedures but does not cover Cost transactions.	• Covers cost transactions, policies, procedures and techniques.
Mandatory Nature	• Compulsory under the Law of Companies.	• Not Compulsory, • Prescribed only for specified Industries.
Objective	• Express an opinion on True and Fair view of Financial Statements.	• Express an opinion on efficiency of performance of Cost Statements.
Periodicity	• Usually 1 Year.	• As per Govt's Order or at regular intervals which may exceed 1 year.
Audit Report	• Submitted to the Members.	• Submitted to the Central Govt and a copy to the Co.

Q.19) Auditing Vs. Investigation

BASIS	AUDITING	INVESTIGATION
Meaning	Independent examination of financial information of any entity	Systematic, Critical and Special examination of records
Purpose	To judge the truthness and fairness of Financial Statements	To establish certain facts
Nature	General Examination	Detailed Examination
Period	Yearly	Depends on requirement
Evidences	Persuasive	Conclusive
Standards Applicable	Standards on Auditing (SA's)	Standards on Related Services (SRS)
Conducted by Whom	Chartered Accountant	Expert Team
Reporting requirement	General purpose report, can be used by many stakeholders	Confidential report, generally restricted to few

Q.20) Special Issues/Problems in Investigation

ISSUE	SOLUTION
1. 100% Verification	• Solution is situation specific • It depends on circumstances. E.g. Cash Defalcation requires 100% detailed scrutiny.
2. Extent of Reliability on Audited Financial Statements	• Where Investigation is ordered due to erroneous accounting, reliance cannot be placed. • Reliance can be placed in other circumstances or unless the terms of appointment requires.
3. Obtaining Opinion of Experts	• Should obtain the written consent of client before discussing the matter with the expert.
4. Case arising out of dispute/conflicting Claims	• Should be Objective and Professional in approach • Should not be biased.
5. Speculative Opinion	• Preferably qualify opinions or • refrain from expressing an opinion stating clearly the reasons thereof.
6. Refuse to be futuristic	• Should not assure the users of Financial Statements about forecast in a certain way.

Q.21) Special Aspects in Business Investigation

1. **Study overall picture :**

   The Investigator should -----
   - have an idea of the overall picture of the entity
   - have an idea of position of the business of the entity
   - establish the line of activity of the entity.

2. **Examination of PandL A/c :**
   - PandL A/c may be reviewed
   - Vertical analysis chart may be prepared to enable comparision over different years
   - Figures should be reconciled with the audited accounts

3. **Examination of Balance Sheet :**
   - Fixed Assets – Costs, Depreciation, Sale, Purchase etc.
   - Investments – Short term/ Long term
   - Stock and WIP – Valuation
   - Debtors – Debtors to Sales Ratio, Bad Debts etc.
   - Liabilities – Whether Under/Overstated
   - Provisions – Provision for taxation, O/s expenses etc.
   - Capital – Classes of Capital, Capital Gearing Ratio etc.

Q.22) Areas in which Due Diligence can take place

1. **Commercial / Operational Due Diligence**
➢ Involves an evaluation from commercial, strategic and operational perspectives.

2. **Financial Due Diligence**
➢ Involves analysis of books of accounts and other information pertaining to financial matters of the entity.

3. **Tax Due Diligence**
➢ Involves encompassing the tax aspects of the entity.

4. **Information System Due Diligence**
➢ Pertaining to all computer systems and related matters of the entity.

5. **Legal Due Diligence**
➢ In respect of legal matters, pending suits, cases/other matters.

6. **Environmental Due Diligence**
➢ To study the entity's environment, its flexibility and adaptiveness.

7. **Personnel Due Diligence**
➢ To ascertain the entity's personnel policies.

Q.23) What is Due Diligence

- The term "DUE DILIGENCE" is used in relation to Corporate Restructuring.
- Corporate Restructuring includes Internal Reconstruction, Amalgamations, Mergers, Joint Ventures etc.
- Due Diligence Review involves careful and sincere study of the situations/demands and possibility of successful implementation of restructuring plans.

Q.24) Steps in Financial Due Diligence Review

➢ Look into the history of the Company
➢ Background of the Promoters
➢ Any restrictions by the Regulatory Authority and to what extent, if any.
➢ Accounting Policies and Practices followed by the Organisation
➢ Details of the management structure
➢ Verify whether Financial Statements are prepared in accordance with relevant statutes
➢ Analyze the trading results of the past
➢ Verify the Assets and Liabilities position
➢ Analyze the components of the Balance Sheet, Net Worth and look for Hidden Liabilities.
➢ Current status of Income Tax Assessments including Appeals pending
➢ Projection of future profitability and financial position
➢ Other matters that might require a review

Q.24) Contents/Features of a Good Due Diligence Report

- ✓ Executive Summary
- ✓ Introduction
- ✓ Background of target
- ✓ Objective of Due Diligence
- ✓ Terms of reference
- ✓ Assessment of
  - Management Structure
  - Net Worth
  - Financial Liabilities
  - Valuation of Assets
- ✓ SWOT Analysis and Comments on future projections
- ✓ Suggestion on various aspects to be taken care of before and after the proposed Org Restructuring.
- ✓ Scope of verification
- ✓ Brief history of the Company
- ✓ Shareholding pattern
- ✓ Observations of the review

Q.25) Investigation on behalf of the Incoming Partner

Main Purpose:

- Sometimes the incoming partner appoints the investigator to examine the affairs of the partnership firm.
- Incoming Partner is interested in judging whether the terms and conditions offered are reasonable.
- On the basis of Investigation, he wants to decide whether it is feasible and desirable to join the firm.

Considerations by Investigator:

- Ascertain the history of inception and growth of the firm.
- Study financial statements of previous years to determine its profitability in the past.
- Compare the rate of return in the firm with the common rate of return in the said field.
- Examine Assets and Liabilities position of the firm.
- Study the provisions of Partnership Deed for composition of partners, profit sharing ratio, capital contribution etc.
- Ascertain the reasons for the offer of admission to a new partner.
- Ascertain the manner of computation of goodwill.

Q.26) Investigation on behalf of Bank/Financial Institutions proposing to Advance Loan

Main Purpose:

Whenever a prospective borrower approaches the bank for a loan, the bank is primarily interested in knowing –

- o Purpose for which loan is required
- o Source from which it would be repaid
- o Security offered by the borrower

Investigator should obtain knowledge on

- The loan proposal submitted by the borrower
- Purpose of loan and repayment schedule
- Creditworthiness and reputation of the Board of Directors
- Historical background and growth trend
- Growth and profit prospects of the company
- Existence of assets which are to be mortgaged for repayment of loan

Examination of Profitability and State of Affairs

- Examine the validity and reasonableness of assumptions made in estimation of Profit After Tax.
- Make a trend analysis of profitability taking into account the amount of borrowings to be raised.
- Study the Cash Flow Statements of the Company to decide whether there has been consistent cash flow from Operating activities.
- Study various items of Balance Sheet

Q.27) Steps for Audit under State level VAT

1. **Knowledge of Business** : The auditor and his team should familiarize themselves with the business of the Auditee.

2. **Knowledge of VAT Laws and Allied Laws :** The auditor and his team should have adequate knowledge of VAT Law, particularly definitions, procedures to be adopted, claiming of Input Tax Credit etc.

3. **Accounting Records :** The auditor should obtain a complete list of all the accounting records relating to sales, purchases, stocks etc.

4. **Major Accounting Policies :** The auditor should ascertain the major accounting policies with regard to sales, purchases and valuation of inventory.

5. **Evaluation of Internal Control :** The auditor should evaluate the internal control prevalent in entity with respect to sales, purchase, production and accounting.

He must examine the adequacy and effectiveness of controls in order to plan nature and timing of audit procedures.

Q.28) Corporate Governance and Audit Committee

CORPORATE GOVERNANCE

- Corporate Governance is a system by which companies are directed and governed by the management in the best interest of stakeholders.
- They provide the guidelines as to how the company can be directed or controlled such that it can fulfill its goals and objectives in a manner that adds to the value of the company and is also beneficial for all stakeholders in the long term.
- Corporate Governance ensures better management, greater transparency and timely financial reporting.

AUDIT COMMITTEE

- An Audit Committee is a key element in the Corporate Governance process of any Organization.
- Audit Committee is considered as an extended arm to assist in accomplishing Board's Objectives.
- It strives to enhance the credibility and integrity of Financial Statements.
- Benefits of Audit Committee –
    - Reduces burden of Top Management
    - Independence of Statutory Auditors
    - Improvement in Internal Control System
    - Better Involvement of Directors

Q.29) Financial Audit Vs. Operational Audit

FINANCIAL AUDIT	OPERATIONAL AUDIT
Provides Opinion on Financial Information	Provides Opinion on efficiency and effectiveness of operations
Conducted by a Chartered Accountant	Conducted by a team of Expert
Conducted Yearly	Depends on the circumstances
Financial Audit Report is sent to all Shareholders and Regulatory Authorities	Operational Audit Report is primarily for management and internal use
It ends in Report	It ends in Report including suggestions

Q.30) Operational Audit Vs. Management Audit

OPERATIONAL AUDIT	MANAGEMENT AUDIT
Focuses on review and appraisal of operations of the organization	Focuses on evaluating manager's ability to manage
Evaluation is objective in nature, since standards are quantifiable	Evaluation is comparatively subjective, since standards are not defined in monetary terms
Operational Auditor should have strong technical and operational background	Mgmt Auditor should have conceptual background. Technical background is desirable but not compulsory.

Q.31) Operational Audit Vs. Internal Audit

OPERATIONAL AUDIT	INTERNAL AUDIT
Focuses on review and appraisal of operations of an organization	Focuses on the function of Internal Control with the objective of determining whether well designed and in place
This does not operate as a part of Internal Control System	It operates as a part of Internal Control System
Constructive function i.e. to provide suggestions for improvement	Protective function i.e. to safeguard the assets of the enterprise
Qualitative aspects are analyzed	Focuses more on quantitative aspects when compared to Operational Audit

Q.32) Objectives of Operational Audit

1. **Appraisal of Controls**
   - The purpose of Operational Audit is to determine whether the Internal Controls are adequate and effective in accomplishing management's objectives.

2. **Evaluation of Performance**
   - The Operational Auditor is concerned with –
     - Analyzing technical efficiency of operation
     - Accumulating information and evidence to measure effectiveness and efficiency

3. **Appraisal of Management Objectives and Plans**
   - The aim of Operational Audit is to appraise operations and controls adherence to prescribed policies.

4. **Appraisal of Organization Structure**
   - Organization Structure, an essential element of Internal Control, provides line of relationship and delegation of authority and tasks.

Q.34) Audit Trail

- Audit Trail can be defined as the –
  - documents,
  - records,
  - journals
  - ledgers
  - master files etc.

  that enables the auditor to trace the transactions from the source document to the summarized total in accounting reports or vice – versa.

- Audit Trail is needed to –
  - Answer queries
  - Fulfill statutory requirements
  - Minimize irregularities
  - Detect consequences of error etc.

Types of Audit Trail

1. **Accounting Audit Trail :** It shows the source and nature of data and process that update the database.

2. **Operational Audit Trail :** It maintains a record of attempted or actual resource consumption within a system.

Q.35) Tests Packs

- Test Pack is a technique to determine the correctness of the computer programming used to record transactions through the computer.
- Preparation of Test Packs requires a great deal of expertise.
- It may be prepared by the Auditor himself with the help of Entity's Staff or by the Internal Control Department of the Entity.

Q.36) Tagging and Tracing

- It includes tagging the client's input data in such a way that relevant information is displayed at key points.
- The hard copy report generated is made available only to the Auditor. This enables him to examine transactions at intermediate steps in processing.
- Advantage of Tagging and Tracing approach lies in the use of actual data and eliminaton of the need for reversing journal entries.

Q.37) Utility Routines

- Utility Routines are generalized programmes that perform necessary but routine jobs in a computer installation.
- They are flexible enough to handle needs of all users and play a key role in EDP system.

Types:

1. Data Set Utilities
2. System Utilities
3. Independent Utilities

Q.38) Energy Audit

- Energy auditing is defined as an activity that
  - serves the purposes of assessing energy use pattern of a factory or
  - energy consuming equipment and
  - identifying energy saving opportunities

- An energy audit can not only reveal ways to help conserve precious energy, it can also save significant amounts of money by maximizing energy efficiency.

- Approaches to Energy Management
  - a) Reducing avoidable losses
  - b) Improving energy use efficiency and effectiveness.

Q.39) Key Functions of Energy Auditor

Following are some of the key functions of the Energy Auditor

- Quantify energy costs and quantities
- Correlate trends of production to energy costs
- Highlight areas that need attention for detailed investigations
- Advise and check the compliance of the Organization for policy and regulation aspect
- Conduct preliminary and detailed audit which includes –
- Data collection and analysis
- Measurements, mass and energy balances
- Reviewing energy procurement practices
- Identification of energy efficient projects
- Establishing action plan and Recommendations on goal setting for
  - Energy saving
  - Record keeping
  - Reporting and Energy Accounting etc.

Q.40) Environmental Audit

- Environmental audits are -
  - reviews of a company's operations and processes
  - for the purpose of assessing compliance with environmental rules and regulations.

- It is the critical analysis of the following aspects that relate to the Environment
  - Policies
  - Principles
  - Systems & Procedures
  - Practices

Q.41) Probable Format of Environmental Statement

Following are the main aspects which may be covered

1. Name and address of the owner/occupier of the industry, operation or process
2. Date of last Environmental Audit Report submitted
3. Consumption of water and other raw materials as input during current and previous years.
4. Pollution generated in air and water with output and types of pollutants and deviation from standard
5. Generation of hazardous waste in current and previous year from processes
6. Disposal practice for different types of waste
7. Practice of conservation of natural resources

Q.42) Human Resource Accounting

- Human Resource is perhaps the most valuable asset in an undertaking.
- It involves measuring the costs incurred by business firms and other organizations to recruit, select, hire, train and develop human assets.
- It also includes measuring the economic value of people to the organization.
- An individual's value to an organization can be defined as the present worth of the set of future services that the person is expected to provide during the period he is anticipated to remain in the organization.

Q. 43) Off-Site Procedures

1. The reviewer would start his review procedures as soon as response of the practice unit to the questionnaire is received. The reviewer should examine the response given by the practice unit.

2. This examination is done -
   - to determine initial sample of the clients to whom attestation services have been rendered; and
   - to obtain basic understanding of the broad framework of quality controlpolicies and procedures under which the practice unit operates.

3. The above examination would provide the reviewer with the knowledge about the practice unit, which would ultimately help the reviewer in developing an appropriate plan for the review.

4. Accordingly, the reviewer would be able to conduct the review in an effective, efficient and timely manner.

Q.44) On-Site Procedures

1. The on-site procedures would begin with the initial meeting with the practice unit. The primary purpose of the initial meeting with the practice unit is to determine the accuracy of the responses given in the questionnaire and seek additional information.

2. Once the reviewer identifies the policies and procedures followed by the practice unit, the reviewer's next task is to perform compliance testing or compliance review.

3. The reviewer should obtain sufficient appropriate review evidence through the performance of compliance and substantive review procedures to enable him to draw reasonable conclusion that the policies and procedures adopted by the practice unit ensure compliance with the technical standards.

4. The reviewer obtains sufficient appropriate review evidence by applying one or more of the following methods:
   - Inspection;
   - Observation; and
   - Inquiry

Q.45) Securities Transaction Tax

- STT is levied on every purchase or sale of securities that are listed on the Indian stock exchanges. This would include shares, derivatives or equity-oriented mutual funds units.

- Securities Transaction Tax or STT is a tax that is levied on all transactions done on the stock exchanges. That means if you purchase or sell equity shares, derivative instruments, equity oriented Mutual Funds, government securities or rights/interest in securities – you have to pay STT.

Q.46) Mandatory Review of Information by Audit Committee

The Audit Committee shall mandatorily review the following information :

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions submitted by management;
3. Management letters / letters of internal control weaknesses issued by the statutory auditors;
4. Internal audit reports relating to internal control weaknesses; and
5. Appointment, removal and terms of remuneration of the Chief internal auditor

Q.47) VOSTRO, NOSTRO & LORO Account

NOSTRO ACCOUNT

- Nostro Account is a bank account held in a foreign country by a domestic bank, denominated in the currency of that country.
- Nostro accounts are used to facilitate settlement of foreign exchange and trade transactions.
- For example the account held by SBI with Bank of America in New York is a Nostro account of SBI.

VOSTRO ACCOUNT

- Accounts that are held by the domestic bank in its home country for foreign banks are called vostro accounts.
- The term is normally applied to the counterparty's account from which funds may be paid into or withdrawn, as a result of a transaction.

LORO ACCOUNT

- A loro account is an account held by one party, administrated by a second party, and audited or assessed by an outside interest.
- Loro accounts are most often used in syndicated financing, and are not common in many parts of the financial industry.
- A loro account is an account seen from the vantage point of a third-party.
- It is not "ours" or "yours" but rather, "theirs."

Q.48) Re-Insurance

- Reinsurance is the process by which an insurance company shares the risk that it assumes when it issues an insurance policy.
- Reinsurance is insurance purchased by insurers from other insurers to limit the total loss an insurer would experience in case of a disaster.
- It allows insurance companies to spread their risk and thereby offer more alternatives to policyholders.

There are two basic methods of reinsurance:

1. **<u>Facultative Reinsurance</u>**
    - Situation where the principal (original) insurer determines what level of risk it should maintain on any one policy, and offers to share the remaining risk with another insurer for a premium.
    - Facultative reinsurance is issued on an individual analysis of the situation and facts of the underlying policy. It may cover all or part of the underlying policy.

2. **<u>Treaty Reinsurance</u>**
    - An automatic reinsurance contract that establishes the conditions under which a class of businesses will be reinsured.
    - It is a standing agreement between insurers and reinsurers. Under a treaty each party automatically accepts specific percentages of the insurer's business.

Q.49) Management Audit Questionnaire:

- A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance.
- Such questionnaires aim at a comprehensive and constructive examination of an organization's management and its assigned tasks.
- Its primary objective is to highlight weaknesses and deficiencies of the organization. It includes a review of how well or badly the management functions of planning, organising, directing and controlling are being performed.
- In addition it evaluates how effective the decision-making process is in accomplishing the stated organization objectives.
- There are three possible answers to the management audit questions: "Yes", "No" and "N.A.", (not applicable).
- A "Yes" answer indicates that the specific area, function, or aspect under study is functioning in an acceptable manner; no written explanation is needed in that case. On the other hand, a "no" answer indicates unacceptable performance and should be explained in writing.If the question does not apply, the N.A. (not applicable) column is checked.

Q.50) Advances to DOT COM Companies

- Assess the existence, adequacy & effectiveness of Internal Control System on the assessment of Borrower's creditworthiness.
- Examine the sanction letter to verify whether it contains –
  - Borrowing Limit
  - Nature of Security
  - Margin to be kept
  - Terms of repayment
  - Other matters
- Verify whether all the necessary documents are executed before the advances are made.
- Examine the feasibility of revenue model submitted by the dot com company. He may obtain expert's advice as well.
- Ensure that there is appropriate capital base in the company i.e. it is not solely dependent on outside sources only.

Q.51) Compliance Review Procedures

INDEPENDENCE

- Does the practice unit have a policy to ensure independence, objectivity and integrity on the part of partners and staff ? Who is responsible for this policy ?
- Does the practice unit communicate these policies and the expected standards of professional behavior to all staff ?
- Does the practice unit monitor compliance with policies and procedures relating to independence ?
- Does the practice unit periodically review the association with clients to ensure objectivity and independence ?

PROFESSIONAL SKILLS AND STANDARDS

- Does the practice unit have an established plan for the personnel needs at all levels ?
- Does the practice unit have an established recruitment policy ?
- Are applicants and new personnel informed of the personnel policies and procedures relevant to them ?
- Does the practice unit have continuing education programmes for partners and staff ?
- Does the practice unit conduct programmes for developing expertise in specialized areas and industries ?

STAFF SUPERVISION AND DEVELOPMENT

- Does the practice unit have written guidelines on the responsibility at each level ?
  And also on expected performance & qualifications necessary for advancement to
  next level ?
- Does the practice unit have a system of periodically counseling personnel on performance and career opportunities ?

- Does the practice unit have a system for gathering and evaluating information on performance of the personnel ?
- Does the practice unit have written guidelines for maintaining working papers (form and content) ?
- Does the practice unit have standardized forms, checklist and questionnaires to assist in the conduct of audit ?

OUTSIDE CONSULTATION

- Is there any policy for consulting experts (both internal and external) ?
- Has the practice unit built up a network of other accountants, solicitors and technical consultants in industries in which its clients operate ?

OFFICE ADMINISTRATION

- Does the practice unit have established procedures for record retention, including security aspects ?
- Does the practice unit maintain a record containing particulars such as client name, nature of engagement, date of commencement of audit, etc ?
- Does the practice unit maintain staff register ?
- Does the office have a proper library containing relevant books and all publications of ICAI ?

Q.52) Cut-off Procedures:

1. Cut-off procedures mean procedures employed to ensure the separation of transactions at the end of one year from those in the commencement of the next year.
2. Usually, the problem of overlapping is found in inventory accounting since quite often goods are sold but passed on to the buyer only after the year is over or goods are bought but received only after the close of the year. This situation may create considerable problem for the proper stock taking of inventory.
3. Therefore, the principal areas of application of cut-off procedures involve sales, purchases and stock.
4. The auditor should satisfy himself by examination and test check that these procedures adequately ensure that:

   (a) Goods purchased for which property has passed to the client have in fact been included in inventories and the liability if any, has been provided for.

   (b) Goods sold have been excluded from the inventories and credit,llas been taken for sales.

Q.53)Areas to be examined in order to investigate Hidden Liabilities

The auditor should pay his attention to the following areas:

- ✓ Contingent liabilities not shown in books
- ✓ Tax liability under direct and indirect taxes.
- ✓ Long pending sales tax assessment.
- ✓ Letters of comforts given to banks and financial institutions
- ✓ Future lease liabilities.

- ✓ Agreement to buy back shares at a stated price.
- ✓ Claims against the company including third party claims.
- ✓ Labour claims under negotiations.
- ✓ Unresolved labour litigations
- ✓ Cases of custom duty where only provisional assessment has been made and final assessment is yet to completed.

Q.54) Areas to be examined in order to investigate Overvalued Assets

The auditor should pay his attention to the following areas:

- ✓ Uncollected/Uncollectible Receivables
- ✓ Assets and property under litigation
- ✓ Investments carrying very low rate of return
- ✓ Intangible assets having no value
- ✓ Obsolete and unused plant & machinery and their spares
- ✓ Assets shown in books above market value due to capitalization of revenue expenditure
- ✓ Obsolete, slow and non-moving inventories valued above NRV

Q.55) Frauds through suppliers' ledger

Frauds

- Adjusting fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.
- Suppressing the Credit Notes issued by suppliers and withdrawing the corresponding amounts not claimed by them.
- Withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid to them.
- Accepting purchase invoices at prices considerably higher than their market prices and collecting the excess amount, paid in cash, from the suppliers.

Investigation :

- Goods Inward book should be examined w.r.t entries made in Supplier's A/c.
- Examine that Credits have been raised in respect of actual goods received.
- Carefully examine whether rebates given by them have been appropriately adjusted or not.
- Special attention should be given to such accounts where supplier is related party.
- Balance Confirmation from them should be obtained to confirm amount due to them.

Q.56) Fraud in Cash Receipts

Frauds

- Issuing a receipt to the payee for full amount collected and entering only a part of the amount on counterfoil.
- Showing a larger cash discount than actually allowed.

- Under –casting the receipts side of Cash Book or Over-casting the payments side.
- Adjusting a cash sale as a credit sale and raising a debit in the account of the customer.
- Carrying over a shorter total or higher total from one page to next with a view to cover up misappropriation.

Investigation :

- First of all, different sources from which income is generated should be ascertained.
- Copies of receipts should be carefully checked.
- Receipts from customers should also be properly examined.
- Ascertain whether income from all sources is accounted or not.
- Ensure that receipts are serially numbered and all receipts have been accounted for.
- In case of cancelled receipt, its original copy should be properly scrutinized.

Q.57) Fraud in Cash Payments

Frauds

- Making double payment of an invoice or paying a false invoice.
- Paying personal expenditure from business by falsifying details.
- Falsely adjusting a refund in the account of customer and withdrawing credit balance.
- Wrong totaling of wage sheets and misappropriating the excess amount withdrawn from bank for payment of wages.

Investigation

- Internal Control on cash payment should be carefully examined to ensure that all payments are properly authorized by the competent authority.
- Acknowledgement for payment should be made against the bill raised by relevant party.
- Payments by bearer cheque can be manipulated. Thus, such payments should be carefully examined.
- Alterations made in the payment records should be carefully examined.
- Payments made to related parties should be specially enquired as possibility of manipulations is high therein.

Q.58) Balances in Customer Ledger

Investigation

- Trace the entries in Order book with the corresponding records in Sales Day Book.
- Examine Customer's account to ensure that they have been properly debited at appropriate amount.
- Scrutinize the amounts written off as Bad Debts.
- Obtain confirmation from Customers in respect of amounts standing in their account.
- Attention should be given to the teeming and lading frauds in such accounts.

Q.59) Haphazard Sampling

Audit sampling can be defined as the process of applying auditing procedures to under 100% of different items in an organization's account balance in a way that every single unit might have an equal probability of being selected.

<u>Haphazard sampling</u>

- The haphazard sampling technique is the one adopted by the auditor in cases where the sample does not follow a structured technique.

- Haphazard selection of sample, may be an acceptable alternative to random selection of sample, provided the auditor attempt to draw a representative sample from the entire population with no intention to either include or exclude specific units.

- When the auditor uses this method, care need to be taken to guard against making a selection that is biased, for example, toward items which are easily located, as they may not be representative.

Q.60) Propriety Audit and its Principles

- Propriety Audit stands for verification of transactions on the tests of public interest commonly accepted customs and standards of conduct.
- Propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company with special regard to public interest and commonly accepted customs, and standards of conduct.
- Propriety requires the transactions, and more particularly expenditure, to conform to certain general principles. These principles are:
    i. That the expenditure is not prima facie more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money;
    ii. That the authority exercises its power of sanctioning expenditure to pass an order which will not directly or directly accrue to its own advantage;
    iii. That funds are not utilised for the benefit of a particular person or group of persons and
    iv. That, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

Q.61) Areas of Propriety Audit U/s.227(1A)

- Whether loans and advances made by the Co. on the basis if security have been properly secured.
- Whether the terms of such loans and advances are not prejudicial to the Co's interest.
- Whether transactions of the Co. which are represented merely by Book Entries are not prejudicial to Co's interest.

- Whether loans and advances made by the Co. have been shown as deposits. Again, considering the propriety element, rationalizing the proper disclosure of loans and advances is made
- Whether personal expenses have been charged to revenue account
- Where the shares have been allotted for cash, whether cash has actually been received in respect of such allotment
- And if no cash is received, whether the position in Books of Accounts and Balance Sheet so stated is correct, regular and misleading.

Q.62) Walk through Tests

- A walk through is a procedure in which an auditor traces a transaction from its initiation through the Co's information systems to the point when it is reflected in the financial reports.
- A Walk through provides evidence to confirm that the auditor understands
  - The process flow of transactions
  - The design of identified controls for internal control components
- A walk through also provide evidence to evaluate the effectiveness of the controls design and confirm that the controls have been placed in operation.
- Once a walk through is performed, the auditor may carry forward the documentation, noting updates, unless significant changes make preparation of new documentation more efficient.

Q.63) Long Form Audit Report

- The Long Form Audit Report is a detailed questionnaire prepared by the Reserve Bank of India.
- LFAR has to be furnished by the auditor of a bank in addition to the audit report as per the statutory requirement.
- The matters which the banks require their auditor to deal with in the form of LFAR have been specified by the RBI.

Q.64) Contingent Liabilities for Banks

The Third Schedule to the Banking Regulation Act,1949 requires the disclosure of the following as a footnote to the Balance Sheet.

(a) Contingent Liabilities

i. Claims against the bank not acknowledged as debts.
ii. Liability for partly paid investments
iii. Liability on account of outstanding forward exchange contracts
iv. Guarantees given on behalf of the constituents
  (a) In India
  (b) Outside India
v. Acceptances, endorsements and other obligations
vi. Other items for which the bank is contingently liable

(b) Bills for Collection

Thanks you

(Give me your response after read out the notes)

Pardeep Rohilla (Hisar)