

“Auditing Q & A”

1. **True and fair concept**

The phrase “**true and fair**” in auditor’s report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit. This requires that the auditor should examine the accounts with a view to verify that all assets, liabilities, income and expenses are stated as amounts which are in accordance with accounting principles and policies which are relevant and no material amount, item or transaction has been omitted.

- To ensure true and fair view, an auditor has to see the following:

- 1) That the assets are neither undervalued or overvalued, according to the applicable accounting principles;
 - 2) No material asset is omitted
 - 3) The charge, if any, on assets are disclosed;
 - 4) Material liability should not be omitted;
 - 5) The profit and loss account discloses all the matters required to be disclosed by Part II of Schedule III and the balance sheet has been prepared in accordance with part I of Schedule III;
- All unusual, exception or non- recurring items have been disclosed separately.

2. **Principles & Techniques of Auditing.**

SA 200 issued by ICAI gives the following basic principles that govern the auditor’s responsibilities.

- 1) **Planning:-** The auditor should obtain the knowledge about client’s business to determine the nature, timing and the extent of the audit procedures.
- 2) **Integrity, objectivity and independence:-** The auditor should be straight-forward, honest, sincere and free from any influence on his audit work.
- 3) **Confidentiality:-** He should not disclose the client’s information to anybody without the client’s permission or under any regulatory requirement.
- 4) **Accounting system and internal controls:-** An understanding of the accounting system and the related internal controls help in determining the nature, timing and extent of other audit procedures.
- 5) **Skills and competence:-** The audit should be performed and audit report be prepared by adequately trained, experienced and competent person.
- 6) **Accounting system and internal controls:-** An understanding of the accounting system and the related internal controls help in determining the nature, timing and extent of other audit procedures.
- 7) **Audit conclusions and reporting:-** On the basis of conclusions drawn from the audit evidence obtained the auditor should give unqualified report or qualified report or adverse report or the disclaimer report.

3. **Quality of successful Auditor.**

The person conducting the audit is known as the auditor.

- 1) Sound knowledge of various disciplines associated with the audit,
- 2) An auditor must possess the integrity and be objective and independent in his approach to the audit work.
- 3) The auditor must have the knowledge of the general principles of the Law governing the auditee enterprise.
- 4) An auditor should also have an understanding of the special features which are peculiar to a particular business. SA 300 (Revised) and SA 310 issued by ICAI lay down principles in this regard.
- 5) Though technical knowledge is necessary to conduct an audit, only those persons whose technical knowledge is backed by basic human qualities can prove to be successful auditors.
- 6) 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.

4. **Advantages of Cost audit.**

- **To the Management -**

1. Management gets reliable data for its day-to-day operations like price fixing, control, decision making, etc.
2. A close and continuous check on all wastage’s will be kept through a proper system of reporting to management.
3. Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
4. Management by exception becomes possible through allocation of responsibilities to individual managers.
5. System of budgetary control and standard costing will be greatly facilitated.
6. Reliable check on valuation of closing stock and work-in-progress can be established.
7. Helps in detection of frauds and errors.

“Auditing Q & A”

- **To the shareholders –**

1. Cost Audit ensures that proper records are kept as to purchases and utilisation of material and expenses incurred on wages, etc.
2. It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis.
3. Thus, the shareholders are assured of a fair return on their investment.

5. **Scope & of Audit in Depth.**

1. A **complete audit** is an audit where the scope of audit is not confined to specific limits, which may be set by the management or any other authority. The auditor is required to check all the possible aspects of a business, including manufacturing operations, data flow processes, accounting records and procedures, etc. In general business practices, it is not feasible to get a complete audit conducted.
2. A **partial audit** is a non statutory audit, which restricts the scope of the auditor to checking of certain specific aspects only. The auditor's powers to enquiry are restricted by his terms of engagement. He may not be allowed to obtain information which falls outside the purview of the scope defined for him. E.g. an auditor may be appointed to check the accuracy of recording of transactions relating to cash sales, or he may be appointed to conduct an audit for the month of Diwali only.
3. **Detailed audit** is also known as audit-in-depth. It involves checking of transactions from the time of their recording till their final effect on the Financial Statements. Every stage that a transaction goes through in the accounting process is closely examined by the auditor using various audit evidences.

6. **According to Sec 227(1) of the Companies Act, 1956, the auditor can call for any explanations or information from the officers and employees of the company.**

The statement is false. According to the Companies Act, 1956 the auditor can call for explanations or information which he thinks is relevant for the purpose of audit and proper discharge of his duties.

7. **The scope of verification is much wider than that of vouching.**

The statement is true. Vouching enables the auditor to know whether the transactions are genuine and valid to enable the auditor to report on the financial statements with reference to relevant documentary evidence. Vouching is the substantive testing/examination of transaction at their point of origin. On other hand, verification process encompasses the inquiry into the ownership/ title, existence, valuation, completeness and presentation of assets and liabilities in the balance sheet. Verification usually deals with the final balance in the Final Accounts viz the balance sheet and profit and loss account.

8. **Auditor is entitled to rely on work performed by others. (Imp)**

SA 200 (AAS 1) on, Basic Principles Governing an Audit envisages manifold circumstances when an auditor would have to depend upon the work performed by others. Such other parties may be experts, other auditors including branch auditors or his own assistants. SA 200 while laying down Work Performed by Others as one of the basic principle governing an audit makes it clear that in cases where the auditor is required to delegate a part of his work to his assistants or use the work performed by other auditors/experts, he continues to remain responsible for expressing his opinion on the financial statements. Thus, he can rely on work performed by others provided he exercises reasonable skill and care and he has no reason to believe that he should not have so relied. The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose. In case of statutory assignments, like relying on audit report of branches conducted by other auditors, he should expressly state the fact of such reliance.

9. **The Cost Auditor of a company cannot function as an internal auditor of the same company.**

The statement is true. The Cost Auditor is required to comment on the scope and performance of the internal audit as per the provisions of the Cost Audit (Report) Rules, 2011. If the Cost Auditor also functions as internal auditor, he will not be able to discharge his duties in proper and dispassionate manner.

10. **Reclassification of long term investment as short term investment is made at cost as on the date of classification.**

The statement is false. As per AS-13, Accounting for Investments' the transfer should be at lower of cost and carrying amount of the investment at the date of reclassification of long term as short term investment.

“Auditing Q & A”

11. **Where the accounts of the company do not present a true and fair view, the auditor of the company can give a qualified opinion.**

The statement is false. An adverse opinion is appropriate where the reservations or the objections are so substantial that the auditor feels, that the accounts do not give a 'True and Fair' view. Qualified opinion would imply that the financial statement project a 'True and Fair' view subject to certain reservations.

12. **For calculating minority interest there is a need to distinguish between capital and revenue profits of the subsidiary.**

The statement is false. Minorities are concerned with their stakes in the holding company. Their right consists of capital and reserves & surplus. To ascertain minority interests, neither capital profit nor revenue profit is necessary.

13. **Internal check is part and parcel of internal control.**

The statement is true. Internal control is a plan of organisation and covers all methods and procedures adopted by management to assist its objectives of ensuring the orderly and efficient conduct of business. It includes financial and physical control and covers internal check and internal audit also. Hence internal check is part of internal control.

14. **Audit is concerned with ethics of business.**

The statement is false. Audit is not concerned with ethics of business unless the business itself is illegal or unlawful.

15. **A company can refuse to provide access to its books of accounts to the company's auditor outside normal working hours of the company , as it will inconvenience the accounts staff.**

The statement is false. Section 227(1) of the Companies Act, 1956, provides that every auditor of a company shall have a right of access to books , accounts and vouchers of the company at all times and shall be entitled to require from the officers of the company such information and explanations as he may think necessary for proper performance of his duties. The auditor thus has the right of access to the records kept by the company at all times and may therefore, inspect them in the course of performance of his duties as auditor. As per law, the company cannot refuse to provide such access after regular office hours.

16. **The appointment of Mr. A as statutory auditor was held to be void ab initio. So the company holds another annual general meeting and appoints Mr. B , through a special resolution.**

Where the appointment of an auditor is void ab initio, it is as if no auditor has been appointed at all. Section 224(3) of the Companies Act, 1956 will come into play. As per this subsection, where at an annual general meeting, no auditors are appointed or reappointed, the Central Government shall appoint a person to fill the vacancy. Hence, in the given situation, the vacancy cannot be filled up by the company, but only by the Central Government. Accordingly, the appointment of Mr. B as new auditor at subsequent meeting will not be valid.

17. **Operational audit is merely an extension of Internal Audit.**

The statement is true. In operational audit function, the internal auditor goes beyond financial controls and looks into operational areas also. Operational auditing having scope and objectives similar to that of Internal Audit is therefore an extent ion of Internal Audit.

18. **Audit Committee has a two-fold relationship and has therefore, to react only with management and Internal Auditor.**

The statement is false. The audit committee has a fourfold responsibility and therefore has to interact with management, internal auditor, statutory auditor and the public.

19. **Shareholders, by a majority vote, have authorized the Board of Directors to keep the books of accounts of the company in its Administrative Office, as against the earlier practice of keeping them in the Registered Office. The ROC was not informed about this change. Company intends that this practice is in order.**

The statement is false. As per Section 209 of the Companies Act, 1956 , the books of accounts can be kept in a place other than its registered office also, but the Board of Directors should within seven days , file a written notice to the Registrar of Companies , the full address of the new place. Here the company has not complied with this mandatory requirement.

20. **There is no need to design better internal controls in an EDP or computerized system.**

The statement is false. Computerisation, automatically implies a constant review of the system to increase the efficiency in producing reliable data. As a result, the internal controls are normally better designed under computerized systems. Automatic checks are instituted and the responsibilities of various people are clearly stated.

“Auditing Q & A”

21. **What is an Audit Evidence?**

Audit evidence refers to any information, verbal or written, obtained by the auditor on which he bases his opinion on financial statements. The audit evidence may be of varied nature and can assume various forms. For example, a signature on the voucher of a designated official, the payee's receipt, etc. Even the information obtained by the auditor by discussing with the officials of the company also constitutes audit evidence AAS 1 (SA 200) on –Basic Principles Governing and Audit, mention audit evidence as one of the basic principles and requires that the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information. According to AAS 5 (SA 500) on Audit Evidence, sufficiency and appropriateness are inter-related and apply to evidence obtained from both compliance and substantive procedures.

22. **What are the assertions with which an auditor is concerned with while obtaining audit evidence from substantive procedures?**

An auditor is concerned with following assertions:-

1. **Existence:** That an asset or liability exists at a given date.
2. **Rights and obligations:** That an asset is a right of the concern and a liability is an obligation at a given date.
3. **Occurrence:** That a transaction or event which took place pertains to the entity during the relevant period.
4. **Completeness:** That there are no unrecorded assets, liabilities or transaction.
5. **Valuation:** That an asset or liability is recorded at an appropriate carrying value.
6. **Measurement:** That a transaction is recorded in the proper amount and revenue or expense is allocated to the proper period.
7. **Presentation and disclosure:** an item is disclosed classified and described in accordance with recognized accounting policies and practices and relevant statutory requirements.

23. **Discuss the principles, which are useful in assessing the reliability of audit evidence.**

The reliability of audit evidence depends on its source-internal or external, and on its nature-visual, documentary, or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence:-

1. External evidence (e.g. confirmation received from third party) is usually more reliable than internal evidence.
2. Internal evidence is more reliable when related internal control is satisfactory.
3. Evidence in the form of documents and written representations is usually more reliable than oral representations.
4. Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

24. **Auditors of M/s FBG (P) Ltd. were changed for the accounting year 2012-13. The closing stock of the company as on 31.3.2012 amounting to Rs. 350 lacs continued as it is and became closing stock as on 31.3.2013. The auditors of the company propose to exclude from their audit programme the audit of closing stock of Rs. 350 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. Give your comments.**

According to SA 510 “Initial Engagements – Opening Balances”, requires that for initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:

1. the closing balances of the preceding period have been correctly brought forward to the current period;
 2. the opening balances do not contain misstatements that materially affect the financial statements for the current period;
 3. appropriate accounting policies are consistently applied.
- 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.
 - General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the balance sheet date. The contention of the management that the stock has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the stock lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude from his audit programme the audit of closing stock.

“Auditing Q & A”

25. ***No depreciation has been charged for the year ended 31st March 2013, in respect of a spare Car purchased during the year and kept ready by the company for use as a stand-by on the ground that it was not used during the year. State your views as an auditor.***

As per 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 has to be charged even in case of these assets which are not used at all during the year but by mere effluxion of time provided such assets qualify as depreciable assets. When the spare car was kept ready for use as stand-by, it means it was intended to be used for the purpose of business. Depreciation in respect of this bus ought to have been provided in the accounts for the year ended 31st March, 2013. If there is an intention to use an asset, though it may not have actually been used, it is a 'constructive' or 'passive' use and eligible for claim of depreciation.

26. ***Fixed assets have been revalued by HIG Ltd. and the resulting surplus has been adjusted against the brought forward losses. What is your opinion as an auditor?***

The revaluation of fixed assets is a normally accepted practice which involves writing up the book value of fixed assets. AS 10 on “Accounting for Fixed Assets” requires 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. Thus, creation of revaluation reserves does not result into any cash inflows and represents unrealised gains. However, brought forward losses are in the nature of revenue losses. As a matter of prudence, revenue losses can be adjusted against revenue reserves only and not the capital reserves. Therefore, the accounting treatment followed by the entity is not correct and the auditor should qualify the audit report by mentioning the above fact.

27. ***Draft the audit programme for audit of receipt of participation fees from delegates to the National Cost Convention. (Imp)***

The organization of three-day National Cost Convention 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:

- ***Internal Control System***
 - a) *Examine the organization structure of special cell created for the National Cost Convention, if any, and division of responsibilities amongst persons and control/custody over receipt books.*
 - b) *Verify the internal control system for restricting the participation of unregistered delegates.*
- ***Rate of Participation Fees***
 - a) *Verify with reference to resolution passed by the Organizing Committee*
 - b) *Also verify the rate from the literature/registration form circulated for promotion of conference.*
- ***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 dishonored cheques.*
 - (v) *Verify subsequent recovery in respect of dishonored cheques.*
- ***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.*
- ***Foreign Delegates:*** *In case of foreign delegates – if registration fees are higher – ensure that they are registered at higher fees.*
- ***Special Issues***
 - (i) *Take out list of absentees and in case of nil absentees, probe the issue further.*
 - (ii) *If certain participant are exempted from payment of fees obtain the list along with proper authorisation in this regard.*

“Auditing Q & A”

28. *The HIJ College, an institution managed by WB Trust, has received a grant of Rs. 5 crore from Government nodal agencies for funding a project of research on rural health systems in India. Draft an audit programme for auditing this fund in the accounts of the college.*

- *Audit of grant fund of a college:*
 - a) *The auditor should obtain the basic documents about the constitution of the college, objectives of the trust, rules of college etc.*
 - b) *The government policy on grant should be checked with the relevant application, brochure, and sanction advices.*
 - c) *The conditions stipulated in award of grant should be studied.*
 - d) *The receipt of grant should be vouched with bank statement.*
 - e) *The budgeted heads of expenses for the project and actual utilization of the fund should be checked.*
 - f) *The purchase of capital items covered within the project should be correctly capitalized. The same should be properly and distinctly shown in the balance sheet of the college. The cost of the asset should be adjusted for the grant amount.*
 - g) *The expenses of revenue nature incurred from and out of grant in the form of salaries to field staff, materials purchased, traveling, survey and field work expenses and analysis and preparation of reports etc should be vouched with the relevant vouchers.*
 - h) *The expenses should be accounted as withdrawal of amounts from the fund. It is to be checked that these expenses are not accounted in income and expenditure of the college.*
 - i) *In balance sheet, the fund account should be shown as a liability with a separate schedule indicating the receipts, payments and balance as on the date of closing of accounts.*
 - j) *The fund balance should be cross checked with the periodical statements of accounts submitted to the nodal agencies.*
 - k) *The physical verification of assets pertaining to the project should be done by the management of the college.*
 - l) *The progress of the project may be ascertained from the minutes, committee meeting extracts and reports. This must be done to ensure that the project fund is genuinely utilized for the purposes it intended for.*

29. *As an auditor, how will you vouch and/or verify the following? (A) Work-in-progress (B) Receipt of special backward area subsidy from Government: (C) Recovery of Bad Debts written off. (D) Borrowing from Banks (E) Machinery acquired under Hire-purchase system.*

- **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:

 - a) *Ascertain that the cost sheets are duly attested by the works engineer and works manager.*
 - b) *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.*
 - c) *Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimated cost expected.*
 - d) *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.*
- **Receipt of special backward area subsidy from Government:**
 - a) *The claim for backward area subsidy submitted to the authorities should be studied.*
 - b) *It should be ascertained whether the grant is of a capital nature for funding assets or of a revenue nature. Mere computation formula of quantum of grant with reference to the cost of project of itself will not make the grant a capital nature is to fact.*
 - c) *The accounting of grant should be in accordance with AS 12 “Accounting for Government Grants”. The revenue grant can be taken to income statement, with appropriate disclosure.*
 - d) *The capital grant may be adjusted against cost of asset or may be kept in a capital reserve to be transferred to profit and loss account each year in proportion to depreciation of that asset charged in profit and loss account.*
 - e) *The receipt of the grant should be checked with bank statement, remittance challan etc.*
 - f) *The conditions attached to grant should be fulfilled by the company. The auditor should check whether any liability or refund of grant for breach of conditions could arise.*

“Auditing Q & A”

- **Recovery of Bad Debts written off:**

- a) Ascertain the total amount of bad debts.
- b) Ensure that all recoveries of bad debts have been properly recorded in the books of account.
- c) Examine notification from the Court or from bankruptcy trustee, letters from collecting agencies or from debtors should also be seen.
- d) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.

- **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:

- a) 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.
- b) 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.
- c) 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.
- d) 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.

- **Machinery acquired under Hire-purchase system:**

- a) Examine the Board's Minute Book approving the purchase on hire-purchase terms.
- b) 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.
- c) Ascertain that the machinery has been included in the related assets account at its cash value. Also instalments due have been paid and the hire-purchase charges applicable to the period from the commencement of the agreement to the end of the financial year have been charged against current profits.
- d) Ensure that machinery acquired on hire purchase basis has been included at its cash value in the balance sheet and depreciation has been calculated on the cash value from the date of the purchase. The amount due to the hire purchase company in respect of the capital outstanding has either been shown as a deduction from the machinery account or as a separate amount under current liabilities.

30. ***As an auditor, comment on the following situations:***

(A) One of the debtors of PQR Ltd. From whom Rs.7 lacs is recoverable for credit sales gives a motor car in full settlement of dues. The directors estimate that the market value of the car transferred is Rs.7.50 lacs. As on date of Balance Sheet, the car has not been registered in the name of PQR Ltd.

According to AS-10, Accounting for Fixed Assets, when fixed asset is acquired in exchange or in part exchange for another asset, the cost of asset acquired should be recorded either at fair market value or net book value of the asset given up. In present case book value is more evident than fair value of car estimated by the directors. Hence, Debtor's A/c should be credited with Rs.7 lacs and motor car recorded at the same amount. Taking principle of substance over form into consideration as laid down in AS 1, the auditor should ensure that the car's acquisition is recorded in the present year though the car is not registered in the name of the auditee.

(B) M/s XYZ Ltd. has taken a Group Gratuity Policy from an Insurance Company. During accounting year 2012-13 it received a communication from an Insurance Company informing that premium amount for the accounting year 2011-12 was less charged by Rs.95 lacs on account of arithmetical error on the part of Insurance Company. M/s XYZ Ltd. paid the said sum of Rs.95 lacs during the accounting year 2012-13 by debiting the same to prior period expenses.

AS-5 has defined prior period expenses as those which arise in current period as a result of error or omission in the preparation of financial statement of one or more prior periods. The nature and amount of prior period items should be separately disclosed in the Profit & Loss A/c in a manner that their impact on current profit or loss can be prescribed. In the given case-

“Auditing Q & A”

- a) *Arithmetical mistake of Rs.95 lacs in computing the amount of premium is not a prior period expense as per AS 5.*
b) *The error was on part of insurance company.*
c) *The accounting treatment by M/s XYZ Ltd. is thus incorrect.*
The auditor should ensure that the disclosure of Rs.95 lacs is an ordinary item in current year's Profit & Loss A/c. This may be disclosed in Notes to Accounts.

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

(A) The company has sent semi-finished goods to third parties for further processing, which is lying with them at the end of the year.

Semi-finished goods being composite part of the inventories, normally, constitute significant item in case of any entity. It is the duty of the auditor to ensure that entire inventories which are owned by the enterprise exist on that date and valuation thereof is also proper. Since the semi-finished goods belong to the company, it is necessary to ensure that the same have been included for in valuation of inventories. The auditor should also obtain direct confirmation about the quantity of inventories lying with the processors at the end of the year. Also, the auditor should see that the valuation has been made properly with reference to the stage of completion in respect of work-in-process inclusive of expenses incurred in sending the goods for processing. In case, the amount happens to be material, such stock may be disclosed separately as stocks with processors.

(B) The management has obtained a certificate from an actuary regarding provision of gratuity payable to employees.

The computation of gratuity liability payable to employees is dependent upon several factors such as age of the employee, expected span of service in the organisation, life expectancy of the employee, prevailing economic environment, etc. Thus, it gives rise to uncertainty in the determination of provisions of liabilities. Under such circumstances, the management is required to make an assessment and estimate the amount of provision. In view of this, the management may engage an expert in the field to assist them in arriving at fair estimation of the liability. Therefore, it is an accepted auditing practice to use the work of an expert. SA 620(AAS 9) on “Using the Work of an Expert” also states that an expert may be engaged/employed by the client. It further requires the auditor to assess skill, competence and objectivity of the expert amongst other factors and evaluate the work of an expert independently to conclude whether or not to rely upon such a certificate obtained by the management from the actuary. Therefore, the auditor must follow the requirements of SA 620(AAS 9) before relying upon the certificate obtained by the management from the actuary.

32. ***Comment on the following situations:***

(A) At an Annual General Meeting, Mr. B a retiring auditor claims that he has been reappointed automatically, as the intended resolution of which a notice had been given to appoint Mr. A, could not be proceeded with, due to Mr. A's death.

*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. B would not hold good.*

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

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 directors 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.

(C) PQR Limited with its registered office at Bangalore has two branch offices located at Mumbai and Kolkata. The accounting transactions of the branches are recorded and the accounting records are maintained in the branches themselves. Only quarterly summarized Trial balance, Profit and Loss account and Balance Sheet are sent to Bangalore office by the branch Accountants. Do you think that the Company is at fault of not maintaining proper books at registered office as per the Company law provisions?

“Auditing Q & A”

According to Section 227 of the Companies Act, 1956, the auditor has to report whether the company has maintained proper books of account. According to section 209 of the Companies Act, the company has to keep at its registered office all the accounting records specified therein. As regards, the records of the branch, Section 209 permits that the same may be maintained at branches provided summarized returns of the branch are sent to registered office at such frequent intervals not less than a quarter. In the present case, since the branches are sending quarterly summarized returns of accounting details, it is deemed that proper books of accounts are maintained at registered office. Hence, there is no statutory violation committed by the company. It may be noted, still the company auditor has right of access (at registered office itself by calling for records) and right to visit the branch.

(D) The members of XYZ Ltd. preferred a complaint against the auditor stating that he has failed to send the auditor's report to them.

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. 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.

33. **As a Company Auditor, how would you deal with the following situations?**

(A) In the books of accounts of M/s WBS Ltd. huge differences are noticed between the control accounts and subsidiary records. The Chief Accounts Officer informs that this is common due to huge volume of business done by the company during the year.

The huge differences found between control accounts and subsidiary records in the books of M/s WBS Ltd. indicate that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause. The contention of Chief Accounts Officer cannot be accepted simply because the company has done huge volume of business. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time. It would also be interesting to see whether it is a recurring phenomenon or such reconciliation could not be done at a subsequent date. Having regard to all these circumstances, it appears from the facts of the case that these differences indicate the possibility of some kind of material misstatements. As per SA 240(AAS 4), “The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements” when the auditor encounters circumstances that there is material misstatement, the auditor should perform procedures to determine whether the financial statements are materially misstated. If as a result of such examination the auditor comes across any material information involving fraud or gross irregularity the same shall be reported by him appropriately.

B) The surplus arising from a change in the basis of accounting was set off by X Ltd., against a non-recurring loss.

AS 5 on “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies” states that any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Transactions which are of an abnormal or non-recurring nature may also be considered material, even though *prima facie*, they do not appear to be material. Materiality is an important and relevant consideration in determining whether or not such exclusion/non-disclosure will distort the true and fair view of the financial statements. Thus, it would be important that users must know the quantum of non-recurring loss. In offsetting and aggregating items, care need to be taken to ensure that material items are not offset against each other. Accordingly, it would not be prudent to set off the surplus emanating from a change in the basis of accounting' against a non-recurring loss'. Accordingly, it would be better to disclose surplus on account of change in the basis of accounting and non-recurring loss separately.

C) Interest on share capital was paid to the shareholders by GHI Ltd. as the company had a long gestation period before it could become operational.

Section 208 of the Companies Act, 1956 permits payment of interest to shareholders out of capital, where there is a long gestation period. Payment of interest on capital is, however, capitalised as part of cost of construction of the project. The auditor should ensure that following conditions have been complied whenever such interest has been paid:

- a) Payment is authorised by the Articles or by special resolution of shareholders in general meeting;
- b) Payment is approved by the Central Government;

“Auditing Q & A”

- c) It is paid only for the period determined by the Central Government not exceeding six months after the half-year in which the project has been completed.
- d) The rate shall not exceed 12% p.a. or such other rate as may be prescribed by the Government.
- e) The payment of interest shall not operate as a reduction of the amount paid-up on the shares which it is paid.

34. **Explain how following are dealt in Auditor's Report as per CARO, 2003?**

(A) No Cost Accounting records are maintained though the company is required to maintain the same.

Under CARO, 2003 where maintenance of cost records, where maintenance of cost records has been prescribed by the Central Government, the auditor of the company is specifically required to state whether such accounts and records as prescribed have been made and maintained. Whether cost audit is ordered or not, the auditor should report on non maintenance of cost records.

(B) A Term Loan was obtained from a bank for Rs. 90 lacs for acquiring R&D equipment, out of which Rs.15 lacs was used to buy a car for use of the concerned director, who was overlooking the R&D activities.

Under CARO, 2003, an auditor is required to comment whether term loans were applied for the purpose for which the loans were obtained. The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact. In the instant case, since term loan taken for the purpose of R&D equipment has been utilized for purchase of car which has no relation with R&D equipment. Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report that the out of term loan of R&D lack, Rs.15 lacs was not utilised for the purpose of acquiring the R & D equipment.

(C) Fixed assets comprising 1/3rd of the total assets have been disposed off during the year by LMN Ltd.

Under CARO, 2003, an auditor is required to state if substantial part of the fixed assets have been disposed off during the year, whether it has affected the going concern. This clause requires the auditor to carry out adequate audit procedures to satisfy himself that the company shall be able to continue as going concern for the foreseeable future despite the sale of substantial part of the fixed assets. Accordingly, in the instant case, the auditor should satisfy himself as to whether disposal off of 1/3rd of fixed assets during the year had any effect on the going concern assumption on account of such sale of fixed assets. The Auditor is required to exercise his professional judgement to determine whether disposal off of one-third of total assets constitutes substantial part or not. Depending upon the judgement arrived at by the auditor, he shall report whether substantial part of fixed assets have been disposed off or not during the year and it has affected or not affected the going concern status of the company. Alternatively, in case the auditor is of the opinion that it constitutes substantial sale but the going concern assumption is appropriate because of mitigating factors then he has to ensure that the same are disclosed in the financial statements or else he shall have to modify the auditor report. The manner of reporting shall also be modified appropriately in case the going concern assumption is resolved or not.

35. **(A) In XYZ LTD, F a junior accountant was given additional responsibility of making recoveries from the debtors. On one occasion, when an insurance claim of Rs.85,000 was received, he credited the same to the account of a debtor and misappropriated the cash which he had recovered from the said debtor. Pinpoint weaknesses in the internal control system which led to this situation.**

Following two essential features of internal control are relevant here:

- a) Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end and
- b) Segregation of accounting and custodial functions.

Weakness in internal control system in the instant case:

- a) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.
- b) It also appears that system for issuing receipts for amount received - whether cash or cheque is also lacking.
- c) In a small and to some extent medium size organization, the supervision of the owner offsets the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking. Thus, in the given case, the main weakness of the system is that it is ignoring the basic requirements of a good internal control system.

“Auditing Q & A”

(B) Elaborate the principles of internal check system that should be followed with regard to cash payments. (Imp)

The principles to be followed are enumerated below:

- a) Making all payments through cheques except petty cash payments.
- b) Segregating duties: The employee in charge of receipts should not be involved in making payments.
- c) All payments should be duly authorized. Payments above Rs.20000 should be tendered through crossed cheque.
- d) The unused cheques should be under proper custody.
- e) The vouchers supporting payments should be stamped as “paid” so that they are not presented twice.
- f) Statement of dues received from creditors should be verified with invoices and ledger accounts before authorizing payments. Confirmation of accounts should be made with creditors.
- g) Monthly or periodic payments should be always be made on fixed dates.
- h) Bank reconciliation statements should be made at least monthly to locate the difference between cash and bank book if any. The statement should be prepared by an independent person not in charge of receipts or payments.

(C) How would you audit “Inventory Control and Management” as an Internal Auditor?

The Internal Auditor should ensure the following as regards “Inventory Control and Management”:

- a) Has the inventory been classified for proper control?
- b) Is A, B, C system of inventory classification followed?
- c) How the inventory levels – maximum, minimum, reorder, economic order quantity fixed?
- d) Is material budget prepared in advance to regulate purchase?
- e) Study the opening/closing stocks of the last few years.
- f) Study the procurement of materials for the last 2/3 years and see whether the same compares favourably with production.
- g) Is there any regular system to assess slow-moving/non-moving stores items for early disposal in cases considered necessary?
- h) Who is the person to declare some material as surplus? Who authorizes its disposal?
- i) Review whether value analysis, PERT etc. are applied for better management of stores.
- j) Work out inventory ratios to judge the reasonableness of inventory build up
 1. working capital to store inventory
 2. Current assets to store inventory
 3. Inventory turnover.

• Some General Aspects:-

- a) Sometimes used materials are returned to stores. In such cases procedure for recording would be the same as followed in case of unused materials except that these may or may not be priced. Usually separate stores ledger / bin cards are opened. See whether the procedure in this regard has been observed.
- b) Review whether any study has been made in regard to mechanization in stores receipt/issue, store accounting.
- c) Review whether proper numerical accounts have been kept in respect to stand by spares.
- d) See whether there is any Material Receiving Report pending disposal – recording valuation in stores ledger/bin card, accounting the accounts records etc.
- e) Review the mode of valuation of closing stock.
- f) How soon the stores schedule is prepared for annual accounts purpose?
- g) Are the stores materials adequately covered by insurance against loss from fire and other risks?
- h) Is there proper coordination between
 1. Central Purchase Department
 2. Local Purchase Department
 3. Stores Department
 4. Stock verification Department
- i) In case there are number of factories producing same / similar products make comparative study regarding –
 1. Surplus materials
 2. Obsolete/slow-moving materials.
 3. Finished/work-in-progress stock
 4. Opening/closing stock of raw material, etc. Apart from the above O and M study may be carried out for standardization of forms, modification of work flow for improvement in efficiency in various directions etc.

36. (A) Discuss the qualities a management auditor should possess.

The management auditor should possess the following qualities:

- a) Ability to understand the nature and objectives and problems faced by the organisation.
- b) He should have general understanding of different laws and regulations like Tax Laws, Company Laws etc.
- c) Expert knowledge of management principles such as delegation of authority, management by exception, budgetary

“Auditing Q & A”

control, flow charts, etc.

- d) Sufficient knowledge and experience in preparing and presenting reports to different levels of management.
- e) Working knowledge of engineering, costing, statistics, management accounting, industrial psychology etc.
- f) Dynamic, tactfulness and a pleasing personality.

(B) What are the main points involved in “Performance Audit” under Government Accounting system?

Performance audit refers to an examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources. The examination is objective and systematic, generally using structured and professionally adopted methodologies. The scope of audit has been extended to cover efficient, economy and effectiveness audit or performance audit. Efficiency audit look into whether various schemes/projects are executed and their operations conducts economically & see that amount spent gives expected result & projects carried out in an economical manner. Economy aspect looks whether government has acquired financial, human and physical resources in an economical manner and that sanctioning and spending authority have observed economy. Effectiveness looks into appraisal of performance of programmes, schemes, projects with overall targeted objectives. Efficiency cum performance audit is examination of Financial & operational aspect of performance. The performance audit involves preliminary study, planning & execution of audit & reporting.

(C) In a system based audit, test checking approach provides a good base for the auditor to form an opinion on the Financial statement. Explain your views.

System-based audit is done by evaluating the accounting system and internal control and ascertaining their reliability through audit tests. Depending upon the size and nature of the business concerned, an accounting system will incorporate necessary internal control to provide assurance that:

- a) All the transactions and information have been recorded,
 - b) Fraud and errors, if any, in preparing the accounts will be identified,
 - c) All the assets and liabilities recorded in the books of account do exist and are shown at correct amounts,
 - d) There is compliance with statutory regulations.
- After the auditor has ascertained the client's accounting system, he should assess it to satisfy the above-mentioned requirements. The auditor, therefore, after evaluating internal control system, tests the same to ascertain whether it is actually in operation. For this purpose, he resorts to actual testing of the system in operation. This he does on a selective basis, i.e., he adopts test checking technique. He plans this testing in such a manner that all the important areas stated above are covered. The test checking is done by application of procedural test and/or by auditing in depth. This approach is adopted in system based audit which is the modern audit approach. The system-based audit approach begins by evaluating the accounting system and internal control and then by testing them to ascertain their reliability. By this, the auditor first establishes how reliable the system is and then decides how much detailed checking of the transactions and verification of assets and liabilities he must undertake. If the system is found to be good, the detailed checking could be curtailed, but if system is weak, more detailed checking would be necessary. However, checking cannot be completely eliminated; it can only be scaled down if state of the system is satisfactory. In case the initial evaluation itself shows weaknesses, extensive checking should invariably be undertaken.

37. Independence of Internal Auditor.

External auditor is more independent than internal auditor in the field of reporting.

- a) Examination of the system of internal check, for both soundness and principle and effectiveness in operation.
- b) Examination and checking of accounting records and statements.
- c) Verification of assets and liabilities.
- d) Observations, inquiry, making of statistical comparisons and such other measures as may be judged necessary.

38. The scope of verification is much wider than that of vouching.

verification includes confirming of whether the assets were in existence on the date of balance sheet, whether assets had been acquired for the purpose of business only, whether the assets had been acquired under a proper authority, whether the right of ownership of the assets vested in the enterprise, whether the assets were free from any charge and whether, the assets were properly valued and disclosed in the balance sheet.

39. Audit evidence from substantive procedures

Substantive procedures (or substantive tests) are those activities which are performed by the auditor during the substantive testing stage of the audit that gather evidence as to the completeness, validity and/ or accuracy of account

“Auditing Q & A”

balances and underlying classes of transactions.

Management impliedly asserts that account balances and underlying classes of transaction do not contain any material misstatements: in other words, that they are materially complete, valid and accurate. Auditors gather evidence about these assertions by undertaking activities referred to as substantive procedures.

40. **Initial Engagement**

- SA 510 on “**Initial Engagement – opening balance**”. As per the said SA it is the duty of the auditor, auditing the financial statements first time, to verify and obtain appropriate audit evidence that:
 - a) The closing balances of the preceding period are correctly brought forward to the current period.
 - b) Whether any misstatement in opening balances is materially affecting the financial statements of the current period and
 - c) Accounting policies followed in the preceding period are also being followed in current period.

41. **Revaluation of Fixed assets.**

- A revaluation means a revision of the book value of capital assets in accordance with a proper appraisal of such assets. Such appraisal includes establishment of proper values by a systematic procedure that encompasses:
 - a) Physical examination of each unit of the plant.
 - b) Engineering estimates of future working.
 - c) Possibility of obsolescence

If a company revalues its assets and shows the same in the Balance Sheet at their replacement cost, depreciation in respect of such assets is to be provided on the basis of the revalued costs.

Any reserve created out of revaluation should not be used for distribution as dividend because revaluation by itself does not create any funds. Only provision of increased depreciation on the revalued cost will result in creation of funds to be utilized for replacement of the assets concerned.

42. **Areas to be covered by an auditor during his course of audit of a Partnership Firm.**

- **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:
 - ✓ 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.
 - ✓ 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.
 - ✓ 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.
 - ✓ 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.
 - ✓ Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
 - ✓ 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.
 - ✓ 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 44AB of the Income-tax Act, 1961 have been complied with.
 - ✓ Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

43. **Subsequent auditor appointed in case of a general meeting.**

1. At the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting;
2. Before such appointment, the written consent of the auditor to such appointment and a certificate from him shall be in accordance with the condition as may be prescribed;

“Auditing Q & A”

3. *Within 15 days of the meeting the company shall file a notice of such appointment with the registrar;*
4. *No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint*
 - a) *An individual as auditor for more than one term of five consecutive years; and*
 - b) *An audit firm as auditor for more than two terms of five consecutive years.*

44. ***Discuss, the rights of an auditor while he is present in a general meeting.***

All notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

45. ***Discuss the areas to be covered by an auditor while splitting the shares of face value from Rs. 10 to Rs. 2 per share of a company.***

1. *Confirm that alteration was authorised by articles.*
2. *Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.*
3. *Verify that alteration had been effected in copies of Memorandum, Articles, etc.*
4. *Verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alteration have been effected therein*

46. ***Submission of Cost Audit Report by the Auditor of a Company.***

The Cost Audit Report should be submitted to Board of Directors of the company – as per section 148(5) of the 2013 Act. After such submission, the company shall furnish the report to Central Government within 30 days, along with full information and explanation on every reservation or qualification contained in the report - section 148(6) of the 2013 Act. The information and explanation is required to be submitted electronically. After considering the report of cost auditor and explanations given by the company, the Central Government can ask for further information and explanations. The company shall submit the same within prescribed time. [section 148(7) of the 2013 Act].

47. ***List the objectives and functions of Auditing and Assurance Standard Board (AASB). (Imp)***

- a) *To review the existing and emerging auditing practices worldwide.*
- b) *To formulate Engagement Standards, Standards on Quality Control and Statement on Auditing.*
- c) *To review and revise the existing Standards and Statements on Auditing.*
- d) *To develop Guidance Notes on issues arising out of any Standard, auditing issues pertaining to any specific industry and revise.*
- e) *To review and revise the existing Guidance Notes.*
- f) *To formulate General Clarifications, where necessary, on issues arising from Standards.*
- g) *To formulate and issue Technical Guides, Practice Manuals, Studies and other papers.*

48. ***Audit procedures necessary in order to gain sufficient audit evidence to be able to form an opinion on the going concern status of a company.***

- *Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. Appropriate disclosure of the nature and implications of the uncertainty is necessary for:*
 - a) *In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or*
 - b) *In the case of a compliance framework, the financial statements not to be misleading.*
- *When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:*
 - a) *Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and*

“Auditing Q & A”

- b) *Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.*
- *If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor's report to:*
 - a) *Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and to*
 - b) *Draw attention to the note in the financial statements.*
- *If adequate disclosure is not made in the financial statements, the auditor shall express a qualified or adverse opinion, as appropriate. The auditor shall state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.*

49. *List the factors that influence an auditor's judgment at the time of obtaining audit evidence and how he obtains such evidence.*

- *The following factors influence auditor's judgement while obtaining audit evidence:*
 - a) *The nature of the item;*
 - b) *The adequacy of internal controls;*
 - c) *The nature and size of the business carried on by the entity;*
 - d) *Situations which may exert an unusual influence on the management;*
 - e) *The financial position of the entity;*
 - f) *The materiality of the item;*
 - g) *The experience gained during the previous audits;*
 - h) *The results of auditing procedures, including fraud or error which may have been found;*
 - i) *The type of information available;*
 - j) *The trend indicated by accounting ratios and analysis.*

50. *Continuous Audit and the advantages of Continuous Audit.*

Continuous audit may be defined as the examination and verification of a firm's financial transactions and their supporting documents, continuously throughout the year, at regular or irregular intervals.

- *The Advantages of Continuous Audit*
 - a) **Early location of errors and frauds:** *It helps in detecting errors and frauds immediately on their occurrence, and not at the year end when it would become difficult to install corrective control mechanisms.*
 - b) **Quick rectification:** *rectification of errors at an early stage is possible.*
 - c) *Continuous guidance to client.*
 - d) **Finalizations of accounts completion in time:** *Just at the end of the accounting period.*
 - e) **Moral check:** *Make employees of the client alert and more efficient in conducting their work.*
 - f) **Improves statutory auditor's focus:** *It relieves statutory auditors of routine testing and allows them to focus efforts on more valuable activities.*

51. *Techniques used to evaluate an Internal Control System.*

- a) **Narrative Record:** *It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.*
- b) **Check List:** *It is a series of instructions that a member of the audit staff is required to follow. They have to be signed/initialed by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.*
- c) **Flow Chart:** *It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results. The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.*

“Auditing Q & A”

- d) **Internal Control Questionnaire:** This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in “Yes” or “No”.

52. **Role of an auditor in verification of Imported Plant & Machinery.**

- a) The Auditor should examine the directors Minute Book for the resolution passed authorizing the purchases.
- b) The Auditor should check the RBI's permission and the import License.
- c) The Auditor should examine the agreement with the foreign supplier, particularly check the terms of payment, interest rates and the basis of deferred Payment.
- d) The Auditor should vouch the bills & receipts relating to purchases, customs duty payment, clearing & shipping charge, insurance premium etc.,
- e) The Auditor should check the entries made in the books of account.

53. **List the areas to be covered while conducting the audit of an NGO incorporated as a company under Section 8 of the Companies Act, 2013.**

- The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:
 - 1. **Corpus fund :** The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with investment Register and physical investments in hand.
 - 2. **Reserves :** Vouch transfers from projects/programmes with donors letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
 - 3. **Ear-marked Funds :** Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
 - 4. **Project/Agency Balances:** Vouch disbursements and expenditures as per agreements with donors for each of the balances.
 - 5. **Loans :** Vouch loans with loan agreements receipt counter –foil issued.
 - 6. **Fixed Assets :** Vouch all acquisitions/sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.
 - 7. **Investments :** Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
 - 8. **Cash in Hand :** Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts.
 - 9. **Bank Balance :** Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
 - 10. **Stock in Hand :** Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.
 - 11. **Programme and Project Expenses :** Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.
 - 12. **Establishment Expenses :** Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.
- **The receipt of income of NGO may be checked on the following lines:**
 - 1. **Contribution and Grants for projects and programmes:** Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
 - 2. **Receipts from Fund arising programmes:** Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
 - 3. **Membership Fees:** Check fees received with membership register, ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.

“Auditing Q & A”

4. **Subscription :** Check with subscription register and receipts issued. Reconcile subscription received with printing and despatch of corresponding magazine/circulars/periodicals. Check the receipts with subscription rate schedule.
5. **Interest and Dividends :** Check the interest and dividends received and receivable with investments held during the year.

54. **No difference between the term Original Voucher and the term Collateral Vouches” – comment**

Original vouchers are called primary vouchers, and their copies or supporting documents are called collateral vouchers

55. **State the meaning of “Voluntary Audit”.**

Audit is not legally obligatory for all types of business organization or institution. On this basis audits may be of two broad categories i.e. audit required under law and voluntary audits.

1. Voluntary audits are non-statutory audits;
2. There is no statutory requirement for audits of sole trader, partnership firm;
3. The sole proprietors and partnership firms may get their accounts audited voluntarily on their own;
4. Except for a statutory tax audit u/s 44AB required as per the Income Tax Act, 1961, e.g. when such an entity exceeds the turnover of certain limit

56. **State the meaning of “Information Security Audit”.**

Information Security Audit is an audit of the level of information security in an organization. The controls in any business organization can be classified as technical, physical and administrative controls. Thus, information security audit involves checking of security controls from the physical security of data centres to the logical security of databases. When centres on the IT aspects of information security, it can be seen as a part of an information technology audit. However, information security encompasses much more than IT.

57. **List the advantages that are associated with proper verification of assets.**

Careful verification of assets fetches the following advantages to the client –

1. It avoids manipulation of accounts
2. It guards against improper use of assets
3. It ensures Proper recording and valuation of assets.
4. It exhibits true and fair view of the state of affairs of the Company.

58. **External confirmations are more reliable evidence than internal confirmations**

The reliability of audit evidence is influenced by its source — internal or external and by its nature—visual, documentary or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained the following generalizations may be useful in assessing the reliability of audit evidence :

- a) External evidence (e.g., confirmation received from a third party) is more reliable than internal evidence.
- b) Internal evidence is more reliable when related internal control is satisfactory.
- c) Evidence obtained by the auditor himself is more reliable than that obtained from the entity.
- d) Evidence in the form of documents and written representations is more reliable than oral representations.

59. **Essentials of an Internal Control System.**

An efficient internal control system should provide:

- a) For proper division of functional responsibilities.
- b) For proper authorization and assignment of duties to perform and record the transactions.
- c) For adoption of proper practices for adherence with management policies.
- d) For proper review and authorization of all transactions before they are recorded in the books and safeguard all business assets.
- e) Proper internal checks
- f) Proper internal audit system.

60. **List the scope of efficiency cum performance audit.**

- a) **Economy Audit:** It ensures that entity has acquired the financial, human and physical resources economically. It implies that resources have been procured in appropriate quantity, quality and at minimum cost.

“Auditing Q & A”

- b) **Efficiency Audit:** It ensures the economical execution of various schemes and policies. It refers to the relationship between inputs and output i.e. the goods and services produced and resources used to produce them, yielding the expected results.
- c) **Effectiveness:** It is an appraisal of the performance of schemes and projects with reference to the overall targeted objectives as well as efficiency of the ways and methods adopted for the attainment of objectives.

61. **Areas to be considered by an auditor regarding Salaries and Wages of an organization, during his audit.**

- i. **Internal Control:** See that an adequate system of internal control exist as to the appointment, promotion, transfer and discharge of employees, recording attendance of workers engaged on the time basis, as well as particulars of jobs performed by piece workers, arrangement for the preparation of wages and salaries bills and their analysis, and sanctioning the disbursement of wages and salaries. The system of internal check should be operational one and that too in an effective manner.
- ii. **Other matters:**
 - a) **Salary and Wage Bill:** Check the salary and wage bill in detail by reference to the record of attendance, schedule of rates, sanctioned by the management for different classes of workers and employees and the sanction for their payment.
 - b) **Dummy Workers:** Examine that the salary and wage sheet contains no names of dummy workers. Also see that the employee or worker who has received the salary or wage has put his initials for the amount received against his name in the sheet.
 - c) **Statutory Deductions:** Check the computation of wages and salaries payable to different workers and employees on taking into account the deduction and other factors such as leave pay, PF, ESI, TDS etc.. into consideration.
 - d) **Mode of Payment:** Check whether the amount has been paid in cash or through cheque or through bank arrangements. Now a days, the companies are also giving the salary in the form of ESOPs etc.
 - e) **Undisbursed Payments:** Ensure that all payments to workers and other employees have been acknowledged and amounts which have remained undisbursed have been deposited back in the bank and credited to the Unpaid Wages and Salaries Accounts.
 - f) **Computation:** Test the correctness of the amount paid by reference to the Annual Return of Salaries, etc., submitted to the Income-tax Authorities and that of wages with Employee's State Insurance Cards.
 - g) **Loans and Advances to employees or workers:** Where loans have been granted to employees or workers, the auditor should trace recoveries out of loans and advances, outstanding against employees into the Employees Loans and Advances Register.
 - h) **Arrangement with Banks:** Where the enterprise has made arrangements with bank as to the deposit of salary and wages in say, 'Salary and Wage Account - XYZ Limited' with the bank, the auditor should prepare a reconciliation statement as to the amount withdrawn and not withdrawn by the employees or workers.

62. **Write a note on - Teeming & Lading.**

Teeming & Leading is a commonly followed method of misappropriation of cash by concealing cash shortages and covering them through recoveries from another customer. It is not uncommon in case of cash collections if the internal check and internal control on cash transactions are not proper.

Teeming and leading may not amount to fraud, but negligence on the part of the management and weaknesses in internal checks or controls may lead to substantial amounts being misappropriated by the cashier. This may result in a huge loss if he is not in a position to clear the debts when caught.

- The auditor has to follow the following procedure for timely detection of teeming and leading:
 - a) Ascertain if the Cash Memos are consecutively numbered, and the dates, name and amount as per the Daily Summary reconcile with relevant cash receipt records.
 - b) Reconcile individual cash amounts as per receipts with records in the Rough Cash Book.
 - c) Reconcile the receipts as recorded in the Rough Cash Book, main Cash Book, pre-numbered Cash Memos, with counterfoils of the pay-in-slips.
 - d) Ensure whether cash receipts are deposited in the bank on a timely basis.
 - e) Examine the Debtors Ledger, especially entries showing part payments, to satisfy that the debtors concerned have indeed made part payments.
 - f) Confirmations may be obtained from the debtors from time to time.

“Auditing Q & A”

63. Discuss the way of verification work conducted in case of revalued fixed assets.

A revaluation means a revision of the book value of capital assets in accordance with a proper appraisal of such assets. Such appraisal includes establishment of proper values by a systematic procedure that encompasses:

- a) Physical examination of each unit of the plant.*
- b) Engineering estimates of future working.*
- c) Possibility of obsolescence*

If a company revalues its assets and shows the same in the Balance Sheet at their replacement cost, depreciation in respect of such assets is to be provided on the basis of the revalued costs.

Any reserve created out of revaluation should not be used for distribution as dividend because revaluation by itself does not create any funds. Only provision of increased depreciation on the revalued cost will result in creation of funds to be utilized for replacement of the assets concerned.

64. State the reasons for disqualification of a voucher.

The following stated defects would disqualify a voucher from being appropriate evidence:

- a) If the date of voucher does not correspond with the date of payment entered in the Cash Book, the auditor may refuse to accept it as an old voucher may have been used to conceal misappropriation.*
- b) If the voucher is not passed by the authorized personnel in the organization.*
- c) The amount of the voucher differs in words and figures.*
- d) The nature of payment in the voucher does not relate to the business.*
- e) The amount of voucher does not tally with the amount entered in the Cash Book.*
- f) The voucher is in the name of an employee/director, and not in the name of the client's company.*

65. Discuss test checking in Audit Work.

Test checking is concerned with selecting and examining a representative sample from a large number of similar items. There is no hard and fast rule of selecting item for the test checking. The justification for the test checking lies in the theory of probability which states that a sample selected from a series of items will tend to exhibit the same characteristics as present in the population, i.e. full series of items. While test checking the following aspects need to be considered:

- a) Presentation and disclosure.*
- b) Adherence to the generally accepted accounting practices.*
- c) Compliance with the statutory requirements.*
- d) Existence of errors and frauds.*
- e) Arithmetical accuracy.*
- f) Materiality of the items involved.*

66. State the purposes of Standards on Internal Audit (SIA).

- a) To provide standards for quality of services during an internal audit*
- b) To codify the best practices in internal audit services*

67. State the process of fixing remuneration of a company auditor as per Companies Act section 142.

- a) The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. Provided that the Board may fix remuneration of the first auditor appointed by it.*
- b) The remuneration under sub-section (1) shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.*

68. Discuss the provisions of the Companies Act regarding signing the Auditors Report by the Auditor as per section 141.

The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141, and the qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

69. Discuss the duties and the power of the company auditor in reference to the audit of the branch and the branch auditor.

“Auditing Q & A”

- a) *For the purposes of sub-section (8) of section 143, the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.*
- b) *The branch auditor shall submit his report to the company's auditor.*
- c) *The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.*

70. Discuss — Audit Report versus Audit Certificate.

- a) *Audit report is an expression of opinion on the truth and fairness of the accounts.*
- b) *Audit certificate is authentication of true and correctness of the data or fact certified.*
- c) *The existence of opinion distinguishes a report from the certificate.*
- d) *The example of audit report is report issued by statutory auditor of a company under Section 143.*
- e) *The example for audit certificate is certification of consumption of imported items to be submitted to the government department for obtaining some license etc.*

71. Explain the matters that do and that do not affect the auditor's opinion.

- *When the Auditor issues any Report other than unqualified, his Report is said to be modified. As per SA 750, an Auditor's Report is considered to be modified when it includes -*
1. *Matters That Do Not Affect the Auditor's Opinion - with Emphasis of Matter Paragraph.*
 2. *Matters That Do Affect the Auditor's Opinion viz:*
 - a) *Qualified Opinion,*
 - b) *Disclaimer of Opinion, and,*
 - c) *Adverse Opinion.*

72. Disadvantages of Continuous Audit.(Very Imp)

- a) *The records and figures in the books of accounts, which have already been checked by the auditor, may be altered after the audit is over.*
- b) *Frequent visits made by the auditor may cause inconvenience at times.*
- c) *The client may suffer due to the clash of duties between his staff and that of the auditor.*
- d) *It is more expensive because the auditor has to devote more time to this audit.*
- e) *The work of audit becomes too mechanical and repetitive.*

73. Internal Audit is an independent appraisal activity within the organization-Discuss the features of Internal Audit.

- a) *It is an independent appraisal activity within the organization.*
- b) *It can be conducted by the staff of the entity or by an independent professional appointed for that purpose.*
- c) *It is conducted for review of accounting, financial and other operations and controls established within an organization.*
- d) *It is conducted as a service to the organization and is not a part of the organization.*
- e) *It intends to furnish the analysis, appraisals, suggestions and information concerning the activities reviewed to the management.*
- f) *Internal auditing functions as a continuous effort for promoting effective control at cost reasonable cost.*

74. Usefulness of Cost data to Company

- *The cost data is useful to company in*
- a) *Price fixation of final products*
 - b) *Controlling wasteful expenditure*
 - c) *Reduction of waste and scrap*
 - d) *Optimum utilisation of labour, material and machinery*
 - e) *Deciding proper product mix to optimise production and profitability*
 - f) *To eliminate loss making products*
 - g) *Improving efficiency*
 - h) *Supplying cost data when required by Government*
 - i) *Taking 'make or buy' decision*
 - j) *Making break even analysis for decision making etc.*

75. Three component of audit risk.

“Auditing Q & A”

- a) **Inherent Risk:** The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
- b) **Control Risk:** The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.
- c) **Detection Risk:** The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

76. **Cash Vouching Procedures**

Cash sales are generally open to a wide scope for commission of frauds and these may be prevented only by an effective system of internal checks and controls.

- After ascertaining the efficiency of the internal check system of cash controls as detailed above, the auditor should vouch cash sales as follows:

<u>Sr No.</u>	<u>Evidences Relevant</u>	<u>Audit Procedures</u>
a)	Compliance of Accounting Manual or laid down Control Systems	To evaluate that the system laid down is proper and the same is being adhered to.
b)	Separate authority to deliver goods and collect cash	To ensure that the salesmen have no authority to deliver the goods to, or receive cash from, the customers.
c)	Three copies of Cash Memo	To verify that there should be at least three copies, preferably in different colors and clearly marked on it the purpose "Original for Customer" and the second copy for the Delivery Counter" are to be delivered to the customer. The third (book copy) remains with the respective salesman.
d)	Stamp – marking by cashier as “paid”	To ensure that the customers present both the copies to the cashier who, upon receiving the payment and stamp-marking the copies as Rs.Paid'; returns the same to the customer.
e)	One copy retained by Delivery Counter	To verify that the second copy with "Paid" stamp is handed over to, and retained by the delivery clerk for his own record of outgo.
f)	Daily Cash Sales Summary for Reconciliation	To verify that the pre-numbered Cash Memos are reconciled with the Daily Cash Summary and that any missing number is vouched for to be recorded in it.
g)	• Bank pay-in-slips • Cash Book - Bank Book - Bank Statement	To check daily deposit of cash as per Cash Sales Summary.
h)	Till Rolls, in case of Automatic Cash Registers	To verify that the daily totals entered in the Cash Book are checked with the Till Rolls.
i)	Stocks Register	The entries in the Stock Register should be reconciled with Daily Cash Sales Summary.
j)	Originals of cancelled Cash Memos	These must be available in original, duly cancelled.
k)	Reconciliations of Cash Sales with: • VAT/Sales Tax returns • Excise Returns • General ledger - Sales Ledger Accounts The cross verifications may be checked to ensure accuracy Audit of	The cross verifications may be checked to ensure accuracy

“Auditing Q & A”

77. ***Vouching of Plant & Machinery.***

As in case of industrial concern out of total assets 20% to 50% cost is that of Plant & Machinery and hence the auditor is required to take much more precaution while verifying the Plant and Machinery and for this he should give attention to following points-

- a) He should get the detailed list of all Plant and Machineries and asset wise accumulated depreciation.*
- b) He should trace the opening balance in the Plant & Machinery register with the help of last year's audited balance sheet.*
- c) He should verify quotations, invoices, cost etc., in connection with Purchase of Plant & Machinery. If there are sales of Plant & Machinery in audit period he should verify the invoice to that effect. He should check the Board Resolution authorizing Purchases of Plant & Machinery.*
- d) If any machinery is disposed off and sold as scrap during the audit period, he should check the authorization and values report in that connection.*
- e) He should check the rates and calculation of depreciation and ensure these are according to the provision of Section 123 of the Companies Act, 2013.*
- f) He should check whether related expenses incurred on purchases of machinery are duly capitalized.*
- g) He should check whether proper accounting of profit earned or loss suffered on Sale of Machinery, during the audit period, is done.*
- h) If any machine is manufactured by the client it self, auditor should verify that capitalization of material, labor and other expenses is properly done.*
- i) He should obtain from the Company management certificate about the verification of all items as required under CARO. [Section 143]*
- j) He should scan the Plant register and physically inspect some of the major plants by visiting to the works.*
- k) He should, finally, ensure appropriate disclosure of all information on the balance sheet as required by the Companies Act. He should obtain a certificate from the local auditor to that effect, if Plant and Machinery is kept abroad at a distant place.*

78. ***Qualified report and Adverse report***

<u>Qualified Report</u>	<u>Adverse Report</u>
<i>1. A Qualified Audit Report is one an Auditor gives an opinion subject to certain reservations.</i>	<i>1. An Adverse Report is given when the concludes that based on his examination, he does not agree with the affirmations made in the Financial Statements / Financial Report.</i>
<i>2. The Auditor's reservation is generally Stated as: 'Subject to the above, we report that the Balance Sheet shows a true and fair view.'</i>	<i>2. The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and working results of the organisation.</i>
<i>3. The accounts present a true and fair view subject to certain reservations.</i>	<i>3. The accounts do not present a true and fair view on the whole.</i>
<i>4. A Qualification is made in the Audit Report when the Auditor has reservation on specific item(s) of material nature.</i>	<i>4. An Adverse Report is given when the Auditor has his reservations on the true and fair view presented by the Financial Statements.</i>

79. ***Principles of an effective Internal Control System.***

- An efficient internal control system should provide:*
 - a) For proper division of functional responsibilities.*
 - b) For proper authorization and assignment of duties to perform and record the transactions.*
 - c) For adoption of proper practices for adherence with management policies.*
 - d) For proper review and authorization of all transactions before they are recorded in the books and safeguard all business assets.*
 - e) Proper internal checks*
 - f) Proper internal audit system.*

80. ***Power & Duties of Auditor***

Powers/Right of Auditor:

“Auditing Q & A”

- a) **Right to access to Books:** Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.
- b) **Right to obtain information and explanation from officers:** This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him.
When the auditor is not provided the information required by him or is denied access to books, etc., his only remedy would be to report to the members that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.
- c) **Right to receive notices and to attend general meeting:** The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.
- d) **Right to report to the members of the company on the accounts examined by him:** The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.
- e) **Right of Comptroller and Auditor-General of India:** In the case of a Government company, the Comptroller and Auditor-General of India shall appoint the auditor of section 139(5) or (7) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.
The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,—
- ✓ **Conduct a supplementary audit** of the financial statement of the company by such person or persons as he may authorise in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and
 - ✓ **Comment upon or supplement such audit report.** Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub section (1) of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.
 - ✓ **Test report.** Further, without prejudice to the provisions of this Chapter, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of Companies Act, 2013, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

Duties of Auditor

- a) **Duty of Auditor to Inquire on certain matters:** It is a duty to inquire into the following matters.
- i. whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

“Auditing Q & A”

- ii. whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
 - iii. where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
 - iv. whether loans and advances made by the company have been shown as deposits;
 - v. whether personal expenses have been charged to revenue account;
 - vi. where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.
- b) **Duty to audit report:** The auditor's report shall also state-
- i. whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
 - ii. whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
 - iii. whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
 - iv. whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
 - v. whether, in his opinion, the financial statements comply with the accounting standards;
 - vi. the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
 - vii. whether any director is disqualified from being appointed as a director of section 164(2);
 - viii. any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
 - ix. whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;
 - x. such other matters as may be prescribed.
- c) **Duty to state the reason for qualification or negative report:** Where any of the matters required to be included in the audit report under this section is answered in the negative or with a qualification, the report shall state the reasons therefor.
- d) **Duty to report on frauds:** if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees. The auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.
- e) **Duty to comply with Auditing Standards:** The Central Government may, in consultation with the National Financial Reporting Authority, by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein. Every auditor shall comply with the auditing standards.

81. **Difference between Statutory audit and Internal audit.**

<u>Sr No.</u>	<u>Statutory Audit</u>	<u>Internal Audit</u>
1.	Mandatory and prescribed by different statutes like for companies, co-operative societies, nationalized banks , banking & insurance companies.	Generally not mandatory. They are discretionary for the management of sole proprietors, partnerships and others.
2.	Statutory Audit is conducted with the objective of ensuring truthfulness and fairness of the Financial Statements of an entity.	Internal audit is conducted with the objective of review of internal controls, checks and financial or non Financial operations of the organization.

“Auditing Q & A”

3.	Scope is prescribed by governing law.	Scope is decided by the management and auditor, and documented through the Letter of Engagement.
4.	The auditor is an independent person and is appointed by the Board of Directors/ shareholders/Central Govt. The audit is conducted on behalf of the shareholders/ govt., as the case may be.	Internal audit can be conducted by any independent agency or by employees of the enterprise. It is conducted on behalf of the management.
5.	To ascertain after critical examination of evidences and records whether Financial Statements are true & fair and no misrepresentation is made therein. To express an independent opinion thereon about the state of health of the entity. Compliance oriented approach.	To ensure that the internal controls are working efficiently, and are in place. To check the accuracy & completeness of records and early detection of errors. Proprietary oriented approach.
6.	A qualified CA in whole time practice or a firm of CAs in practice can be a statutory auditor	No qualification is prescribed.
7.	Term ends at the conclusion of the next AGM (annual general meeting). However, the auditor can be reappointed if not disqualified.	The term is generally mutually decided.
8.	Report to shareholders/ owners in a format prescribed under law.	Report to the management. No prescribed format.

82. **State the areas of operation that are involved in an internal audit. (Imp)**

According to the Institute of Internal Auditors, internal audit involves five areas of operations:

- a) **Reliability and integrity of financial and operating information:** Internal auditors should review the reliability and integrity of financial and operating information and the means used to identify, measures, classify and report such information.
- b) **Compliance with laws, policies, plans, procedures and regulations:** Internal auditor should review the systems established to ensure compliance with those policies, plan and procedures, law and regulations which could have a significant impact on operations and reports and should determine whether the organization is in compliance thereof.
- c) **Safeguarding of Assets:** Internal auditors should verify the existence of assets and should review the means of safeguarding assets.
- d) **Economic and efficient use of resources:** Internal auditor should ensure the economic and efficient use of resources available.
- e) **Accomplishing of established objectives and goals for operations:** Internal auditor should review operation or programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

83. **Discuss Expenditure Audit in relation to the Government Audit. (Imp)**

The basic standards set for audit of expenditure are to ensure that there is provision of funds authorized by competent authority fixing the limits within which expenditure can be incurred. Some standards are briefly explained below:

- a) **Audit against Rules & Orders:** It is also known as Regularity Audit. Under this, 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 orders framed by the competent authority.
- b) **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, authorizing such expenditure. In case expenditure exceeds the sanctioned limit, objection is raised.
- c) **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 sanctioned amount as well as examine whether the money has been spent for the specified purpose.
- d) **Audit of financial propriety:** The auditor has to ensure that the expenditure incurred are with respect to the recognized standards of financial propriety i.e. quantity, quality, morality and ethics.

“Auditing Q & A”

84. State the procedure for removal of statutory auditor before the Expiry of his term as per Companies Act, 2013.

The auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner.

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

85. Whether an Auditor opinion in a financial statement is persuasive or a conclusive in nature (Imp)

Auditors opinion in a financial statement is persuasive and not a conclusive in nature. In the financial statement, auditors gives their conclusion but based on that conclusion, user of the financial statement can't conclude the future viability of the Company or firm and took a decision on the basis of that opinion.

86. Mr. T. auditor of SAU Ltd. is of the opinion that “Standards on Auditing” are meant only for references and it is not necessary to follow such Standards on Auditing.

Contention of Mr. T is totally wrong and is against the fundamental assumptions and guidelines governing auditing and assurance standards.

As per ICAI, while discharging their attest function, it will be the duty of the members of the Institute to ensure that the SAs are followed. The SAs will apply whenever an independent financial audit is carried out to express an opinion thereon.

The member of the Institute must follow the SAs. The auditors must draw attention to the material departures from SA in their audit report along with the reasons for such departure.

Auditors in their report have to mention that audit was conducted in accordance with “Generally accepted auditing standards” in Indian context.

Hence Mr. 'T' is duty bound to follow the SAs.

87. What is the purpose of audit.

The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

88. Who are the intended users of the Financial Statement.

- The intended users of the financial statement are
 - i. Existing and prospective shareholder of the company,
 - ii. Preference shareholder of the company,
 - iii. Debenture holder of the company,
 - iv. Banker's of the company,
 - v. Debtor's of the company,
 - vi. Creditor's of the company,
 - vii. Government authorities- I.Tax, IDT, ROC, Ministry of corporate affairs
 - viii. Lender's of the company,
 - ix. Other authorities.

89. Discuss the Basic Principles Governing an Audit (Or) what are the Basic Principles Governing an Audit as laid down in SA200.

- In conducting an audit of financial statements, the basic principles for governing an Audit is laid down below:
 - a) The Auditor should obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and thereby enabling him to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework;
 - b) The Auditor is liable to report on the financial statements, and communicate this to the management and where appropriate Those Charged with Governance, as required by the SAs, in accordance with the auditor's findings and opinion.

“Auditing Q & A”

- c) *The Auditor is required to obtain sufficient appropriate audit evidence about whether material mis-statements exists, through designing and implementing appropriate responses to the assessed risks.*
- d) *When reasonable assurance cannot be obtained and a qualified opinion in the auditor’s report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the SAs require that the auditor should disclaim an opinion or withdraw from the engagement, where withdrawal is legally permitted.*

90. What are the objectives of audit.

- *The objective of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the giving of an opinion by the auditor on whether the financial statements are prepared and presented, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.*
- *The auditor’s opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some cases, however, the applicable laws and regulations may require auditors to express opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. The Auditor shall have an understanding of the entire text of an SA, including its Application and other Explanatory Material, to understand its objectives and to apply its requirements properly.*
- *The financial statements subject to audit are those of the entity, prepared and presented by management of the entity with oversight from those charged with governance. SAs do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with SAs is conducted on the premise that management and, where appropriate, those charged with governance have responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of those responsibilities.*
- *The mandates for audits of the financial statements of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), may be broader than those of other entities. As a result, the premise, relating to management’s responsibilities, on which an audit of the financial statements of such an entity is conducted may include additional responsibilities, such as, the responsibility for the execution of transactions and events in accordance with legislation or proper authority*

91. “An Auditor is responsible for expressing opinion on financial statements in statutory Audit.” — Discuss,

- *The SAs require that the Auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of an Audit and among other things. By applying these skills and judgment, the auditor express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework.*
- *An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion. It is a duty of an Auditor to form an opinion on the Financial Statements based on conclusions drawn from the audit evidence obtained. The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable laws or regulations. The auditor may also have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, in relation to matters arising from the audit. These may be established by the SAs or by applicable laws or regulations.*
- *The opinion expressed by the auditor is on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The form of the auditor’s opinion, however, will depend upon the applicable financial reporting framework and any applicable laws or regulations. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, preparation of the financial statements in accordance with the applicable financial reporting framework includes presentation.*
- *Where the financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the SAs is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. Where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework. Unless specifically stated otherwise, references in the SAs to the auditor’s opinion cover both forms of*

“Auditing Q & A”

opinion.

92. **“The audit of financial statements relieves management of its responsibilities” — Comment.**

- The financial statements subject to audit are those of the entity, prepared and presented by management of the entity with oversight from those charged with governance. SAs do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with SAs is conducted on the premise that management and, where appropriate, those charged with governance have responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of those responsibilities.
- An audit in accordance with SAs is conducted on the premise that 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. As part of their responsibility for the preparation and presentation of the financial statements, management and, where appropriate, those charged with governance are responsible for:
- The identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
- The preparation and presentation of the financial statements in accordance with that framework.
- An adequate description of that framework in the financial statements.

The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.
- Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain agreement from management and, where appropriate, those charged with governance that they acknowledge and understand their responsibilities as a precondition for accepting the audit engagement. The auditor is also required to obtain written representations about whether management and, where appropriate, those charged with governance have fulfilled those responsibilities.

93. **“Some material misstatements remain unreported by Auditors” — Comment.**

- 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 statements¹. In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in the light of surrounding circumstances, and are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. The auditor's opinion deals with the financial statements as a whole and Therefore the auditor is not responsible for the detection of misstatements that are not material to the financial statements as a whole.
- **Risk of material misstatement** – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:
 - i. **Inherent risk** – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
 - ii. **Control risk** – The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

“Auditing Q & A”

94. ***Audit Opinion is not an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise — Comment.***

The auditor's opinion does not assure, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. The reason for this statement is that the auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. In some cases, however, the applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

95. ***As an auditor of Escape Ltd. you have asked your audit assistant to draw the audit programme. The assistant drew up the audit programme without going through the monthly report of the Internal Auditor on the plea that he is a Chartered Accountant and have found no serious irregularities and internal control system is running perfectly.***

The contention of the audit assistant is not valid and contrary to the view and guidelines given in (SA 200).

As per (SA 200), the basic principles governing an audit are integrity, objectivity and independence. Objectivity implies that auditor's opinion should be based on facts and evidences collected through audit procedure.

Skill and competence also requires an auditor to exercise due professional care in performing the audit.

The SA also requires auditor to rely on internal control only after studying and evaluating them.

In the instant case all those basic principles have not been followed by the auditor.

Reliance based on position of the person and blindly accepting the soundness of the internal control violates the basic principles.

Only by evaluation the auditor will know whether the internal audit and related internal control is effective or not.

96. ***What is meant by Reasonable assurance.***

As the basis for the auditor's opinion, SAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, 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.

97. ***Who is responsible for preparation and presentation of financial statements.***

The Management and where appropriate those charged with Governance are responsible for preparation and presentation of financial statement. An audit in accordance with SAs is conducted on the premise that 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.*

“Auditing Q & A”

98. What are the duties at firm level vis a vis quality control.

Quality control systems, policies and procedures are the responsibility of the audit firm. Under SQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

- a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and
- b) The reports issued by the firm or engagement partners are appropriate in the circumstances.
- c) This SA is premised on the basis that the firm is subject to SQC 1.

[SQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance; and
- Monitoring.]

Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise.

99. List the Objectives of quality control procedures to be adopted by an audit firm.

- The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:
 - a) The audit complies with professional standards and regulatory and legal requirements; and
 - b) The auditor's report issued is appropriate in the circumstances.

100. List the quality control procedures to be adopted at the individual audit level.

The procedures of quality control are the responsibility of the audit firm. The firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance.

The system of quality control includes procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance; and
- Monitoring.

101. Mr. Black, Partner of Black & Co, Chartered Accounts died of a heart attack on 30th March, after completing the entire routing audit work of T Ltd. Mr. Lal, one of the partners of the firm therefore signed the accounts of T Ltd, without reviewing the finalization work done by the assistants. State your views with reasons.

SA 200 “Work Performed by others” as one of the basic principles. The following principles are laid down:

- a) When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information.
- b) However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.
- c) The auditor should carefully direct, supervise and review work delegated to assistants.

- ✓ **Aspects of Review:** The auditor is responsible for forming and expressing his opinion on the financial statements. He should review the work performed by each assistant on the following aspects:

“Auditing Q & A”

- a) **Audit Programme:** Whether the work has been performed in accordance with the audit programme,
 - b) **Documentation:** Whether the work performed and the results obtained have been adequately documented,
 - c) **Audit queries:** Whether all significant audit matters have been resolved or are reflected in audit conclusions,
 - d) **Audit procedures:** Whether the objectives of the audit procedures have been achieved, and
 - e) **Audit Opinion:** Whether the conclusions expressed are consistent with the results of the work performed and support the audit opinion.
- ✓ **Analysis:** In the present case, whether Mr. Black, the deceased partner had reviewed the work performed by assistants or not, is not clearly stated.
- Hence, it shall be the duty of Mr. Lal, to review the work performed by the assistants before expressing his opinion. Mr. Lal should review the working papers carefully, carry test checks and scrutinize the audit file thoroughly.

102. Write short notes on “Supervision of Audit work”.

Supervision of Audit work: AAS-17 on quality control for audit work requires that personnel carrying out the supervisory responsibility should perform the following functions during the audit:

- a) Monitor the progress of the audit to consider whether the assistants have the necessary skills and competence, understanding of the audit directions and are discharging their work as per audit programme,
- b) Collect and address significant audit questions raised during the audit and based on their significance modifying the overall audit plan and programme and
- c) Resolve any difference of professional judgment with appropriate consultation.

103. What are audit working papers? Why should they be carefully preserved by the auditor.

- **Audit Working Papers:** These refer to the documents prepared or obtained by the Auditor and retained by him in connection with the performance of his audit. Working papers should have the following features:
 1. **Record of plan:** working papers should record the following:
 - Audit plan
 - Nature, timing and extent of auditing procedures performed
 - Conclusions drawn from the evidence obtained.
 2. **Proper design and Organisation:**
 - Working papers should have design and properly organized to meet the condition of each audit and the Auditor's requirement in respect thereof.
 - Standardization of working papers improves the efficiency with which they are prepared and reviewed.
 3. **Completeness:** it should be carefully completed and detailed for an Auditor to obtain an overall understanding of audit. The extent of documentation is based on Auditor's judgment. It is neither necessary nor practical that the Auditor should content very observation, consideration or conclusions in his working papers.
 4. **Significance:** All significant matters which require the exercise of judgment together with auditor's conclusion thereon should be included in the working papers.
 5. **Evidence furnished by client:** to improve the audit efficiency, the auditor generally obtains and utilizes schedules, analyses and other working papers prepared by the client. In such case, the auditor the auditor should satisfy himself that these working papers have been properly prepared.
 6. **Classification:** working paper files may be classified as — (a) Permanent Audit Files, which are updated currently with information of continuing importance to succeeding audits and (b) Current Audit Files, which contain information relating primarily to the audit of a single period.

Firms to establish policies and procedures for the retention of engagement documentation.¹⁴ The retention period for audit engagements ordinarily is no shorter than ten years from the date of the auditor's report, or, if later, the date of the group auditor's report.

The Auditor need not to include in audit documentation the superceded drafts of Working Papers and Financial Statements, Notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

104. M/s Health Zone, a Partnership firm running a Nursing Home, has decided to discontinue you as an auditor for the next year, and requests you to handover all the relevant working papers of the previous years. Comment. OR Discuss the concept of “Lien on Working papers”.

“Auditing Q & A”

1. **Auditor’s Lien on own Working Papers:** Lien arises only in case of other person’s property. Hence, the question of lien on the Working Papers does not arise since they belong to the Auditor.
2. **Client’s Access to Working Papers:**
 - a) **Requirement under CA Act, 1949:** Under the Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his Client, without the consent of his Client or otherwise than as required by any law for the time being in force.
 - b) **Auditors’ Position:**
 - Unless otherwise specified by law or regulation, Audit Documentation is the property of the Auditor.
 - He may at his discretion, make portions of, or extracts from, audit documentation 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 his personnel.
3. **Principal Auditor’s Access to Branch Auditor’s Working Papers:**
 - a) The Statutory Auditor has to consider the report of the Branch Auditor and has a right to seek clarifications and I or to visit the Branch if he deems it necessary to do so for the performance of the duties as Auditor. The Statutory Auditor’s right of access to Branch Records does not automatically extend to the Branch Auditor’s Working Papers.
 - b) As per SA - 600, when considered necessary, the Principal Auditor may require the Branch Auditor to answer a detailed questionnaire regarding matters on which information is required. The Branch Auditor should respond to such questionnaire. The Branch Auditor, knowing the context in which his work is to be used by the Principal Auditor, should co-ordinate with him and assists him actively.
 - c) As per ICAI’s Guidance Note on Auditors’ Duties when Clients 1 Other Auditors seek access to his Working Papers, the Main Auditors of an enterprise do not have the right of access to the Audit Working Papers of the Branch Auditors.
 - d) Hence, there is no specific requirement for the Branch Auditor to make available the photocopy of his Working Papers to the Company’s Statutory Auditor.

105. **A CA Firm, Established in 1958 were the Auditors of a PSU for the Years 1984-85, 1985-86 and 1986-87. They were also auditors of a few nationalized bank branches and insurance offices. They are still keeping audit working papers/files for all these years. Suggest whether there is any guideline/law or rules regarding the period for which the audit working files should be kept? Is it also relevant for other audits (i.e. Private limited companies, partnership firms, Trusts etc.).**

- a) AAS 3/SA230: The auditor is required to retain his working papers for a period of time sufficient to:
 - i. Meet the needs of his practice, and
 - ii. Satisfy any pertinent legal or professional requirements of record retention.
- b) ICAI’s View: The ICAI has recommended that an auditor should maintain his records relating to audit and other work done including routine correspondence and other papers for a minimum period of 10 years.
- c) Effect of pending proceedings: The limit of 10 years is only the minimum period if there are no legal or professional proceedings pending in respect of those records/Working papers.
- d) Applicability for other audits: The requirements as to the period of retention of the audit working papers would be applicable for other audits also i.e., audits of private companies, partnership firms trusts, etc.

106. **List the auditor’s duties under SA250 in consideration of laws and regulations in his audit.**

This SA distinguishes the auditor’s duties in relation to compliance with two different categories of laws and regulations as follows:

- a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and labour laws. and
- b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity’s ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements

“Auditing Q & A”

- In this SA, differing requirements are specified for each of the above categories of laws and regulations. For the category referred to in paragraph
 - a) Above, the auditor’s responsibility is to obtain sufficient appropriate audit evidence about compliance with the provisions of those laws and regulations. For the category referred to in paragraph
 - b) The auditor’s responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.
- As part of obtaining an understanding of the entity and its environment in accordance with SA 315 the auditor shall obtain a general understanding of:
 - a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and
 - b) How the entity is complying with that framework.The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements.

107. Discuss briefly the role of a statutory auditor in relation to unlawful acts or defaults by the clients. OR What should the auditor do when noncompliance is discovered.

- **Reporting Non-Compliance to Those Charged with Governance:**

Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor, the auditor shall communicate with those charged with governance matters involving noncompliance with laws and regulations that come to the auditor’s attention during the course of the audit, other than when the matters are clearly inconsequential.

If, in the auditor’s judgment, the non-compliance is believed to be intentional and material, the auditor shall communicate the matter to those charged with governance as soon as practicable.

If the auditor suspects that management or those charged with governance are involved in non-compliance, the auditor shall communicate the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board. Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice.

- **Reporting Non-Compliance in the Auditor’s Report on the Financial Statements:**

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall, express a qualified or adverse opinion on the financial statements.

If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit.

If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor’s opinion.

- **Reporting Non-Compliance to Regulatory and Enforcement Authorities:**

If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity.

- **Documentation:**

The auditor shall document identified or suspected non-compliance with laws and regulations and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.

108. Highlight the principles in SA 299 on Division of work among joint auditors

Where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of work would usually be in terms of audit of identifiable units or specified areas. In some cases, due to the nature of the business of the entity under audit, such a division of work may not be possible. In such situations, the division of work may be with reference to items of assets or liabilities or income or expenditure or with reference to periods of time. Certain areas of work, owing to their importance or owing to the nature of the work involved, would often not be divided and would be covered by all the joint auditors.

“Auditing Q & A”

The division of work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

109. *Bring out the nature of responsibility of joint auditors. OR The responsibilities of joint auditors are joint and several.*

In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible –

- a) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;*
- b) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;*
- c) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;*
- d) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute;*
- e) for ensuring that the audit report complies with the requirements of the relevant statute.*

110. *If there is difference of opinion among the joint auditors with respect to any matter, majority joint auditor's opinion will prevail while reporting. Comment*

- **Joint Report:** Normally, the joint auditors are able to arrive at an agreed report. In such circumstances, only one Audit Report shall be given and it should be signed by all the joint auditors.
- **Disagreement in Views:** It is the duties and rights of those Auditors among the Joint Auditors where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report.
- **Majority rule not applicable:** A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement. So, it can be said that if there is any difference of opinion among the joint auditors with respect to any matter, majority joint auditor's opinion will not prevail while reporting.

111. *The overall audit strategy and audit plan is subject to updates and changes during the course of audit. Comment*

The auditor shall update and change the overall audit strategy and the audit plan as and when necessary during the course of the audit.

As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls.

112. *What is the objective of Audit Programme OR What is meant by Audit Programme?*

The auditor should prepare a written audit programme setting forth the procedures that are needed to implement the audit plan. The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of the work.

In preparing the audit programme, the auditor, having an understanding of the accounting system and related internal controls, may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. The auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

“Auditing Q & A”

The auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example,

when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.

The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be considered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

113. Mr. Ananda pursuing CA and doing articleship from a reputed firm in Kolkata, Chakraborty & Co. One of the partners of the firm assigned him a job for drafting Audit Programme of a manufacturing company. What are the basic sources of documents to be considered for drafting audit programme.

- *The following basic documents for drafting Audit Programme may be considered by Ananda:*
 - i. *Internal Audit Report,*
 - ii. *Financial Statement of previous years,*
 - iii. *Tax audit report,*
 - iv. *Manual of the company, if any,*
 - v. *System file or Permanent file,*
 - vi. *Working paper of last year,*
 - vii. *By understanding the accounting package of the company*
 - viii. *Ledger of the company*
 - ix. *Type of report required by management of the company*
 - x. *Interaction with the client*
 - xi. *By understanding the working procedure and internal control of the company, etc.*

114. How does an auditor determine whether a particular item is material or not.

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

- *Misstatements, including omissions, are considered to be material 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;*
- *Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and*
- *Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.*

The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

- a) *Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;*
- b) *Understand that financial statements are prepared, presented and audited to levels of materiality;*
- c) *Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and*
- d) *Make reasonable economic decisions on the basis of the information in the financial statements.*

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. Although, it is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.

“Auditing Q & A”

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

- **Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole:**

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as profit before tax, total revenue, gross profit and total expenses, total equity or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.

115. **“Auditor's assessment of materiality may be different of the time of planning the engagement than at the time of evaluating the results of his audit procedures”. Comment**

- Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leaves no margin for possible undetected misstatements. Performance materiality (which, as defined, is one or more amounts) is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. Similarly, performance materiality relating to a materiality level determined for a particular class of transactions, account balance or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance or disclosure exceeds the materiality level for that particular class of transactions, account balance or disclosure. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures; and the nature and extent of misstatements identified in previous audits and thereby the auditor's expectations in relation to misstatements in the current period.

116. **An assistant of RZ & Co, Chartered Accounts, detected an error of Rs. 6 per interest payment, which recurred a number of times. The General Manager (Finance) of Empty Ltd advised him not to request for passing any adjustment entry as individually the errors were of very small amounts. The Company had 2,000 deposit accounts and interest was paid quarterly. State your views in this issue, with reasons.**

- a) **Principle:** Mis-statements including omissions are considered to be material, if they either individually or in aggregate, could reasonably be expected to influence the economic decisions of the users, using the Financial Statements.
- b) **Analysis:** In the above case, an error of Rs. 6 per interest payment, even if small individually, will have a material effect due to the large number of transactions (2,000 deposit accounts).
- c) **Conclusions:** Hence, RZ & Co, need not to pay any attention to the advise given by the General Manager (Finance) of Empty Ltd. The necessary adjustment should therefore be carried out in the accounts of the company.

“Auditing Q & A”

117. *On the audit of Dreamlight Ltd. the audit partner of the engagement set the preliminary level of audit materiality at Rs.1,200,000. After, the partner reviewed the audit of senior's assessment of inherent risk, he decided that the materiality level should be increased to Rs.1,800,000. Required:*

- A) *What is the relationship between materiality and audit risk?*
B) *How will this new level of materiality affect the nature and extent of auditing procedures.*

A) *The relationship between materiality and audit risk:*

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.

In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for:

- a) *Determining the nature, timing and extent of risk assessment procedures;*
- b) *Identifying and assessing the risks of material misstatement; and*
- c) *Determining the nature, timing and extent of further audit procedures.*

In conducting an audit of financial statements, the overall objectives of the auditor are 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 to report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings. The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

- a) *Identifying and assessing the risks of material misstatement;*
- b) *Determining the nature, timing and extent of further audit procedures; and*
- c) *Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.*

B) *The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially (Initially Rs. 1,200,000 and revised at Rs. 1,800,000).*

- *If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.*
- *Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures. For example, if during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.*

118. *Outline the mode of obtaining evidence in respect of opening balances under SA510.*

In an initial audit engagement, the auditor will have to satisfy about the sufficiency and appropriateness of “Opening Balances” to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow in cases –

- (i) When the financial statements are audited for the preceding period by another auditor, and*
- (ii) When the financial statements are audited for the first time.*

The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

- *The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:*

“Auditing Q & A”

- a) *Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss for;*
- b) *Determining whether the opening balances reflect the application of appropriate accounting policies; and*
- c) *Performing one or more of the following:*
 - i. *Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;*
 - ii. *Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or*
 - iii. *Performing specific audit procedures to obtain evidence regarding the opening balances.*
- a) *If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.*
- b) *If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements.*
- c) *If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with Proposed SA 705 and Proposed SA 710 (Revised).*

119. Mr. SR, a chartered accountant and a partner of SR & Co., Chartered Accountants was first time appointed the auditor of Microvan Ltd. Mr. SR carried the audit procedure for verifying the opening balances only but not the previous year accounting policies as Mr. SR thinks that as per standard on auditing – 510 it is not needed. Comment.

The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

If the auditor concludes that:

- a) *the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or*
- b) *a change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework, the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with Proposed SA 705.*

The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on various matters. One of those matters is the accounting policies followed by the entity. So it is necessary to verify the consistency of the accounting policies followed by the enterprise in the previous accounting year.

120. Mr. S. a Chartered Accountant, was first time appointed as the Auditor of Titan Ltd. Mr. S. carried the audit procedure for verifying the opening balances only, but not the previous year's accounting policies as it is not needed.

Contention of Mr. S, the auditor, is not correct and contrary to the SA 510 on “Initial Engagement – opening balance”. As per the said SA it is the duty of the auditor, auditing the financial statements first time, to verify and obtain appropriate audit evidence that:

- a) *The closing balances of the preceding period are correctly brought forward to the current period.*
 - b) *Whether any misstatement in opening balances is materially affecting the financial statements of the current period and*
 - c) *Accounting policies followed in the preceding period are also being followed in current period.*
- Hence, in view of the above guidelines of SA 510 Mr. S should verify the accounting policies also to ensure its continuity.*

121. What types of analysis are covered by analytical procedures OR Write short notes on analytical review procedures.

- *Analytical procedures include the analysis of comparisons of the entity's financial information with, for example:*
 - a) *Comparable information for prior periods.*
 - b) *Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.*

“Auditing Q & A”

- c) *Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.*
- *Analytical procedures also include the analysis of relationships, for example:*
 - a) *Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.*
 - b) *Between financial information and relevant non-financial information, such as payroll costs to number of employees.*

122. What are the purposes of 'Analytical Procedures'.

- *The purposes of 'Analytical Procedures' are:*
 - a) *To obtain relevant and reliable audit evidence for evaluation of financial information through analysis of plausible relationships among both financial and non-financial data, when using substantive analytical procedures; and*
 - b) *To design and perform analytical procedures near the end of the audit that assists the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.*

123. Summarize the auditor's duties in applying analytical procedures. OR Explain how the results of analytical review can influence the nature and extent of other audit work. OR To what extent analytical procedures can be relied upon? OR Write short notes on the extent of reliance on analytical procedures.

- *When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:*
 - a) *Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;*
 - b) *Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;*
 - c) *Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and*
 - d) *Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.*

The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- a) *Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and*
- b) *Performing other audit procedures as necessary in the circumstances.*

124. What factors should be considered while analytical procedures are performed as substantive procedures?

This Standard on Auditing (SA) deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"). The use of analytical procedures as risk assessment procedures is dealt with in SA 315. SA 330 includes requirements and guidance regarding the nature, timing and extent of audit procedures in response to assessed risks; these audit procedures may include substantive analytical procedures.

The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.

125. You are the auditor's of Play Limited for the first time this year.

Play Limited is a retailer of sports goods and sportswear with more than 110 retail outlets in towns throughout India. Not all the stores sell clothing. You are required to explain the purpose of analytical review and the procedures you would adopt at the planning stage of the audit.

“Auditing Q & A”

The purpose of analytical review include the consideration of comparisons of the entity’s financial information with, for example:

- *Comparable information for prior periods.*
- *Anticipated results of the entity, such as budgets or expectations of the auditor, such as an estimation of depreciation.*
- *Similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.*
- *Among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages.*
- *Between financial information and relevant non-financial information, such as payroll costs to number of employees.*

The procedures which may be adopted are described below:

126. *Outline the Auditor’s Duties under SA540 Vis à vis Accounting Estimates.*

- *The auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent reestimation for the purpose of the current period. The nature and extent of the auditor’s review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.*
- *The auditor shall determine whether, in the auditor’s judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.*
- *Based on the assessed risks of material misstatement, the auditor shall determine:*
 - a) *Whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; and*
 - b) *Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances.*
- *In responding to the assessed risks of material misstatement, as required by SA 330, the auditor shall undertake one or more of the following, taking account of the nature of the accounting estimate:*
 - a) *Determine whether events occurring up to the date of the auditor’s report provide audit evidence regarding the accounting estimate.*
 - b) *Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether:*
 - i. *The method of measurement used is appropriate in the circumstances; and*
 - ii. *The assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework.*
 - c) *Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures.*
 - d) *Develop a point estimate or a range to evaluate management’s point estimate. For this purpose:*
 - i. *When the auditor uses assumptions or methods that differ from management’s, the auditor shall obtain an understanding of management’s assumptions or methods sufficient to establish that the auditor’s point estimate or range takes into account relevant variables and to evaluate any significant differences from management’s point estimate.*
 - ii. *When the auditor concludes that it is appropriate to use a range, the auditor shall narrow the range, based on audit evidence available, until all outcomes within the range are considered reasonable.*
- *In responding to the assessed risks of material misstatement, the auditor shall consider whether specialized skills or knowledge in relation to one or more aspects of the accounting estimates are required in order to obtain sufficient appropriate audit evidence.*

127. *Write short note on events occurring after balance sheet date.*

- *Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:*
 - (a) *Those that provide evidence of conditions that existed at the date of the financial statements; and*
 - (b) *Those that provide evidence of conditions that arose after the date of the financial statements.*

“Auditing Q & A”

- *The date of the auditor’s report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.*
- *The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements have been identified.*
The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.
- *After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, when, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report, the auditor shall:*
 - (a) *Discuss the matter with management and, where appropriate, those charged with governance.*
 - (b) *Determine whether the financial statements need amendment*
 - (c) *Inquire how management intends to address the matter in the financial statements.*
- *Depending on the auditor’s risk assessment, the audit procedures may include procedures, necessary to obtain sufficient appropriate audit evidence, involving the review or testing of accounting records or transactions occurring between the date of the financial statements and the date of the auditor’s report.*
- *The audit procedures in addition to procedures that the auditor may perform for other purposes that, nevertheless, may provide evidence about subsequent events (for example, to obtain audit evidence for account balances as at the date of the financial statements, such as cut-off procedures or procedures in relation to subsequent receipts of accounts receivable).*

128. ***Explain the meaning of the term subsequent events as used in SA560. Should all types of subsequent events be considered by the auditor in his attest function.***

- ***Subsequent events*** – Events occurring between the date of the financial statements and the date of the auditor’s report, and facts that become known to the auditor after the date of the auditor’s report. The following types of subsequent events can be described as follows:
- ***Events Occurring Between the Date of the Financial Statements and the Date of the Auditor’s Report*** — The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.
- ***Facts Which Become Known to the Auditor After the Date of the Auditor’s Report but Before the Date the Financial Statements are Issued*** — The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor’s report. However, when, after the date of the auditor’s report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report, the auditor shall:
 - (a) *Discuss the matter with management and, where appropriate, those charged with governance.*
 - (b) *Determine whether the financial statements need amendment and, if so, inquire how management intends to address the matter in the financial statements.*
- *When the audited financial statements are included in other documents subsequent to the issuance of the financial statements, the auditor may have additional responsibilities relating to subsequent events that the auditor may need to consider, such as legal or regulatory requirements involving the offering of securities to the public in jurisdictions in which the securities are being offered. For example, the auditor may be required to perform additional audit procedures to the date of the final offering document. These procedures may include those performed up to a date at or near the effective date of the final offering document, and reading the offering document to assess whether the other information in the offering document is consistent with the financial information with which the auditor is associated.*
- *The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. Depending on the auditor’s risk assessment, the audit procedures required to obtain sufficient appropriate audit evidence, involving the review or testing of accounting records or transactions occurring between the date of the financial statements and the date of the auditor’s report. The audit procedures required are in addition to procedures that the auditor may perform for other purposes that, nevertheless, may provide evidence about subsequent events.*

“Auditing Q & A”

129. **Indicate briefly the procedures to identify subsequent events requiring adjustment of or disclosure in financial statements. OR How are subsequent events requiring adjustment or disclosure identified?**

- The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.
- The auditor shall perform the procedures so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:
 - a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
 - b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
 - c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
 - d) Reading the entity's latest subsequent interim financial statements, if any.
- When, as a result of the procedures performed, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

130. **You are the Auditor of Manufacturing Company whose year ends on 30th June.**

The following events occur after the year and before you complete the audit. The audit report issued by you is dated 20th September.

- Consideration of subsequent events:
 - (1) SA560 requires that the Auditor should consider the effect of subsequent events (a) on the financial statements, and (b) On the Auditor's Report.
 - (2) The manner and treatment of each event depends upon its nature, i.e. (a) Adjusting event, or (b) None Adjusting Event.
 - (3) The auditor's duties in report of each of the above situations is Described below,
- a) **The Sales ledger balance at 30th June were Rs. 85,000. By 20th September, cash had been received against this amount totaling Rs. 62,000.**
- Debtors remaining uncollected:
 - (1) Examine the actual experience of the company in collecting due to it.
 - (2) Examine the terms under which goods are sold and see to what extent they are being exceeded.
 - (3) Verify whether the amount still remaining due will be collected in the immediately foreseeable future.
 - (4) Review the correspondence with debtors since the yearend.
 - (5) Ascertain the need, if any, to create provision for Bad Debts.
 - (6) Discuss the necessary Bad Debts provision with the company's Directors, to make necessary adjustments in the financial statements, if required.
- b) **On 19th August, a Batch of goods which were shown in the stock records at 30th June at a cost of Rs. 12,000 was sold for Rs. 27,000 and another batch costing Rs. 40,000 was sold for Rs. 20,000.**
- Stocks sold below cost:
 - (1) **Valuation of stock:** As per prudent accounting principles and AS2. Stocks should be valued at lower of cost or net realizable value. For this purpose, stocks have to be considered on an item by item basis or in groups and not in total.
 - (2) **Goods sold above cost:** in respect of items costing Rs. 12,000 and sold at Rs. 27,000 in the next period, there is further evidence as to the realisability. Hence, such items should be stated at cost and the profit should be considered only in the next accounting period.

“Auditing Q & A”

(3) **Goods sold below cost:** In respect of items costing Rs. 40,000 but sold for Rs. 20,000, the subsequent event provides an indication of its realizable value/market price as at the balance sheet date. Hence, such goods shall be valued at Net Realizable Value as on 31st June. The necessary adjustment should be made in the financial statements of this period.

c) **A customer who had purchased a large consignment of goods during the accounting year claimed damages of Rs. 48,000 because the goods were faulty and unfit for use.**

The company has denied any liability.

- (1) The Auditor should advise the company to obtain legal advice on this matter to establish –
 - (a) Whether there was any Legal liability, and
 - (b) What would be the extent of the potential damages.
- (2) The company should identify the extent of the liability to know whether any excessive claim has been made by the claimant, which is not likely to be endorsed by the courts.
- (3) In case of ascertainable Liability: The company, on legal advice, should make a provision in its accounts as at 30th June, to cover the estimated amount of damages payable together with legal costs.
- (4) In case of unascertained liability, if the amount payable cannot be estimated it should be shown as a contingent liability in the Notes to the Accounts as at 30th June.

d) **A warehouse was destroyed by fire on 31st July containing stocks which were worth Rs. 1,10,000. The warehouse was valued in the company's books at worth Rs. 90,000.**

State giving reasons, for your answer, how the above events would affect the account for the year ending 30th June.

- **Fire subsequent to Balance Sheet Date:**
 - (1) The fire took place after the yearend, and hence its accounting effect should be reflected in the next year's accounts.
 - (2) In case of material losses, adequate disclosure shall be made in the report of the Board of Directors.
 - (3) The Auditor should examine the appropriateness of the going concern Assumption and report accordingly.

131. **Sundry Debtors of a company as on 31st March include Rs.12 lakhs From M/s Boston Traders, who have been declared as insolvent on 14th April. Comment.**

- (a) **SA560:** SA560 requires that the Auditor should consider the effect of Subsequent Events
 - (i) On the financial Statements, and
 - (ii) On the Auditor's Report.
- (b) **AS4:** AS4 requires that all significant events occurring after the balance sheet date and before the date of approval of the financial statements by the Board of Directors should be adjusted against assets/ liabilities as on Balance Sheet date, if additional evidence is available in respect of conditions existed on the Balance Sheet Date.
- (c) **Companies Act:** As per schedule III Balance Sheet Disclosure Requirements, Debtors should be classified by nature into
 - (i) Fully Secured Debts,
 - (ii) Debts Secured only by Debtor's Personal security, and
 - (iii) Debts considered Doubtful or bad.
- (d) **Analysis and Conclusion:**

In the Given case, Debtors should be suitably adjusted in the financial statements, to show their realizable amount, since conditions existed on the balance sheet date in respect of which additional evidence has been provided by the insolvency of M/s unreliable Trades.

So, the Auditor should examine the Company's compliance with AS4, and report accordingly.

132. **X Ltd. was under audit for the year ended 31st March. An appeal filed by X Ltd. against the demand of excise duty of Rs. 25 Crores was pending before the supreme court for which neither provision was made nor was disclosed in the notes to the financial statements. On 12th July, the Auditor came to know through paper reports that the point involved in the appeal of X Ltd was adjudicated by the supreme court in the case of some other assessee, which is in favour of the department of excise duty. The auditor insisted that provisions be made of Rs. 25 Crores in the financial statements. The Management was of the view that since its own case is still pending, no provisions is called for. It was also of the view that the event does not have any effect on the financial position of the company on the B/s date. Is the management view tenable?**

“Auditing Q & A”

- As per AS 29, a provision should be recognized if the following conditions are satisfied: Present obligation as result of past event, outflow of resources to settle the obligation is probable. Reliable estimate of the amount of excise duty demand is already made on the company. Hence present obligation exists at the Balance sheet date. Additional evidence arising after Balance Sheet date lead to the conclusion that the outflow is probable, i.e. more likely than not. Rs. 25 Crores is the amount of liability (Given).
- **Treatment and conclusion:** Since all the conditions for recognition of a provision are satisfied, a provision should be recognized for the year ending 31st March. If the amount is material, separate disclosure is also required. The Management's contention is not tenable.
- Auditor's Duties: Under SA560, the Auditor should:
 - (a) Consider the effect of subsequent events on the financial statements & Auditor's report.
 - (b) Verify whether such identified events materially affect the financial statements.
 - (c) If so, see that they are properly accounted for in the financial statements.
 - (d) Express a qualified opinion or an adverse opinion as considered appropriate, when the management does not account for such events.

133. **List the indications upon which the Auditor should assess the appropriateness of going concern assumption. OR There is evidence that the public interest would be best served by the inclusion of fuller information about risks facing companies in audited financial statements. Doubts about the going concern presumption must be detected and adequately disclosed in financial statements and Auditor's Reports. You are required to list six factors, which might cause doubt on the going concern status of a company. OR**
ZT Ltd has suffered recurring losses due to steep fall in production and has negative net worth. Its production head, an expert, has also left the company. Reply of the management is inadequate to these developments and there is no sound action plan to mitigate these situations. As an auditor, how would you deal with the situation.

- Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis is relevant. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.
- The auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.
- When performing risk assessment procedures as required by SA 315, the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern.
- The following are indications of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists.

✓ **Financial**

- 1) Net liability or net current liability position.
- 2) Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- 3) Indications of withdrawal of financial support by creditors.
- 4) Negative operating cash flows indicated by historical or prospective financial statements.
- 5) Adverse key financial ratios.
- 6) Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- 7) Arrears or discontinuance of dividends.
- 8) Inability to pay creditors on due dates.
- 9) Inability to comply with the terms of loan agreements.
- 10) Change from credit to cash-on-delivery transactions with suppliers.
- 11) Inability to obtain financing for essential new product development or other essential investments.

“Auditing Q & A”

✓ Operating

- 1) *Management intentions to liquidate the entity or to cease operations.*
- 2) *Loss of key management without replacement.*
- 3) *Loss of a major market, key customer(s), franchise, license, or principal supplier(s).*
- 4) *Labour difficulties.*
- 5) *Shortages of important supplies.*
- 6) *Emergence of a highly successful competitor.*

✓ Other

- 1) *Non-compliance with capital or other statutory requirements.*
 - 2) *Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.*
 - 3) *Changes in law or regulation or government policy expected to adversely affect the entity.*
 - 4) *Uninsured or underinsured catastrophes when they occur.*
- *The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.*

134. Specify additional audit procedures, which an auditor may perform while evaluating appropriateness of going concern assumption.

- *When events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:*
 - a) *When management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.*
 - b) *Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.*
 - c) *When the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action:*
 - i. *Evaluating the reliability of the underlying data generated to prepare the forecast; and*
 - ii. *Determining whether there is adequate support for the assumptions underlying the forecast.*
 - d) *Considering whether any additional facts or information have become available since the date on which management made its assessment.*
 - e) *Requesting written representations from management or, where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.*

135. Describe the audit procedures necessary in order to gain sufficient audit evidence to be able to form an opinion on the going concern status of a company.

- *Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for:*
 - a) *In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or*
 - b) *In the case of a compliance framework, the financial statements not to be misleading.*
- *When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:*
 - a) *Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and*

“Auditing Q & A”

- b) *Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.*
- *If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor's report to:*
 - a) *Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and to*
 - b) *Draw attention to the note in the financial statements.*
- *If adequate disclosure is not made in the financial statements, the auditor shall express a qualified or adverse opinion, as appropriate. The auditor shall state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.*

136. It is now an accepted fact that an auditor cannot take the “Going concern” assumption for granted. The problem has become acute in view of ever growing sickness in our industries. You are required to prepare a checklist designed to test the assumption that a particular client organization is in fact a going concern.

- **SA 570 Checklist:** *If the answers to the following questions are “Yes”, then the going concern assumption may not be appropriate, subject to other findings of the auditor.*

1. Capital structure and financial aspects:

- a) *Does the concern have a high Debt Equity Ratio?*
- b) *Is the concern heavily or increasingly dependent upon short term finance?*
- c) *Is the company utilizing the borrowing facility to the maximum or whether there is any scope for further borrowing?*
- d) *Are leasing arrangements preferred to capital expenditure?*

2. Working capital aspects:

- a) *Is there a gradual and significant decline in current ratio, i.e. current assets, Current liabilities?*
- b) *Are purchases being deferred, thereby reducing stocks to dangerously low levels?*
- c) *Is there a marked slowdown in the collection of sundry Debtors?*
- d) *Is there any inability to take advantage of cash discounts from creditors?*
- e) *Is there any increase in the time taken to pay creditors?*

3. Operational Aspects:

- a) *Are there substantial investments in R & D projects, which have not yielded any commercially exploitable products?*
- b) *Has there been any cancellation of capital projects for lack of funds?*
- c) *Is the concern substantially dependent upon a few products/patents/ production methods which may suddenly become obsolete?*
- d) *Is the business of the concern dependent upon the growth of a handful of customers?*
- e) *Are there substantial loans from directors, in case of small concerns? If such loans rank pari passu with other unsecured creditors, has the current ratio deteriorated?*
- f) *Are there defaults in making statutory payments like taxes, ESI, PF etc.?*

4. Profit and Loss Account Aspects:

- a) *Does the concern incur substantial cash losses?*
- b) *Is there a steady decline in the rate of profitability?*
- c) *Is there a growth beyond limits such that the company is over trading?*

137. Where a public or private company fails to enhance the paid up capital to the statutory minimum, will the going concern assumption be considered appropriate.

- a) *The minimum paid up capital of a private limited company and public limited company are Rs. 1 lakh and Rs. 5 lakhs respectively. Where a company fails to enhance the paid up capital to the statutory minimum, such company shall be deemed a defunct company within the meaning of section 248 of the companies Act, 2013 and its name shall be struck off from the register by the ROC.*
- b) *However, such an entity may decide not to carry on business or may decide to carry on the business in some other form of organization e.g. Partnership etc. This situation gives rise to the risk that the going concern assumption may no longer be appropriate.*

“Auditing Q & A”

- c) *In such situations, the auditor should perform the procedures as required by SA 570. Unless the entity demonstrates otherwise, the auditor should consider the going concern assumption as inappropriate and report the same in accordance with Para 18 of SA 570.*

138. Explain what is meant by “Representation by management” and indicate to what extent an auditor can place reliance on such representations. Or Write short notes on Management representation Or Briefly out the salient features of SA580 Representations by Management.

SA 580 elaborate the term Written representation as below

- *Written representations – A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.*
- *For purposes of this SA, references to “management” should be read as “management and, where appropriate, those charged with governance.” Furthermore, in the case of a fair presentation framework, management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting framework; or the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework. If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A26-A27)*
In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A25)
If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor’s report in accordance with (Proposed) SA 7056, having regard to the requirement in paragraph 19 of this SA.

139. Discuss the position of an auditor in case he chooses to rely upon the certificates from the management in respect of closing stock, cash in Hand etc. List the circumstances under which he will be justified in accepting and relying upon the certificates.

1. **Role of management representations:**
 - a) *Management representations are generally given for certifying the value of inventories, provision for Liabilities, Disclosure of contingent Liabilities, etc. These are intended to impress upon the Directors their responsibility for accounts.*
 - b) *Mere Possession of such certificates does not absolve the auditor from carrying out a proper audit. These certificates can only act as second line of defense for an auditor who has carried out his work with reasonable care, skill and diligence.*
 - c) *The auditor should not seek or accept certificates from the management when the subject matter is such that it is capable of direct verification by the auditor himself.*
2. **Situations when management certificates can be justifiable:**
 - a) *The subject matter should not be capable of direct verification by the Auditor.*
 - b) *The matter relates to items, which are beyond the competence of a professionally qualifies Accountant.*
 - c) *There are proper records and reliable internal checks in the client’s system that can enable the directors to prepare and issue the certificates.*
 - d) *The certificate should be prima facie in agreement with the records maintained.*
 - e) *The certificate should be put to commonsense tests by the auditor.*
3. **In case of Third party certificates e.g. Bankers, Architects, Agents etc. the following rules of reliance may be taken into account:**
 - a) *The party issuing the certificate is reputable and trustworthy,*
 - b) *The certificates relate to an item which is normally dealt with or held by such party,*
 - c) *The auditor himself is not in a position to verify the item because of its technical nature or because it would be too costly or cumbersome for him to do so,*

“Auditing Q & A”

- d) *The certificate prima facie is reliable and reasonable, and*
- e) *Reference to the third party if available in the books and documents of the client as in possession of the concerned goods, property or securities belonging to the clients.*

140. ***The Managing Director of a client company as returned to your draft of the letter of representation stating that the Directors Fail to see why such a letter is necessary and declaiming to issue one. How would you deal with the above situation.***

- *If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A26-A27)*
- *In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A25)*
- *If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with (Proposed) SA 7056, having regard to the requirement in paragraph 19 of this SA.*

141. ***At the statutory audit of IDT limited, the physical verification of fixed assets was conducted. However, the auditor was not able to confirm the existence of valuables and important machinery. In this connection, the auditor obtained a certificate from the management to prove its existence and value and accepted the same blindly without any audit procedures. As a statutory auditor, how will you deal with the above issue? OR***

An auditor of DT Ltd. was not able to get the confirmation about the existence and value of certain machineries. However, the management gave him a certificate to prove the existence and value of the machinery as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?

1. ***Management's Duties:*** *Physical verification of fixed assets is the primary responsibility of the management. But, the auditor should examine the verification programme adopted by the management. Through his audit procedures, the auditor must satisfy himself about the existence, ownership and valuation of fixed Assets.*
2. ***Auditor's Duties:***
 - a) *Under SA580, when a management representation relates to matters which are material to the financial information, the auditor should seek corroborative audit evidence for other sources inside or outside the entity. He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be will informed on the matter.*
 - b) *The Auditor should also report whether he has obtained all information and explanations which are necessary for the purpose of his audit. As per the generally accepted audit principles, he is required to verify the existence of fixed assets.*
 - c) *If a representation by management is contradicted by other evidence, the auditor should examine the circumstances and, also reconsider the reliability of other representations made by management.*
 - d) *The auditor is also guilty of professional misconduct in case he expresses an opinion on financial statements without obtaining sufficient information warranting such opinion.*
3. ***Role of Management Representations:*** *Representation by Management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.*

If the auditor is unable to obtain sufficient appropriate audit evidence regarding a matter which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination, even if he has obtained a representation from management on the matter. Therefore, the auditor's approach in the above case is not correct.
4. ***Conclusion:*** *If the auditor expresses a clean opinion on the financial statements based on management's certificate only without any further audit procedures, he will be guilty of dereliction of duties statutorily prescribed under the companies Act. Hence, he should not express a clean opinion on the financial statements in the given case.*

“Auditing Q & A”

142. *Discuss the principal Auditor's Procedures as enshrined in SA 600. State any six procedures to be adopted by the principal auditor in using the work of other auditors. OR Rajat & Co. has been appointed as Auditors of ABC Ltd situated at Kolkata. Harsh & Co., another firm of CA's has been appointed as Auditors for a division of the same company at Shimla. What procedures should Rajat & Co. follow while using the work of Harsh & Co. with respect to the Financial information of Shimla division, included in the Financial information of ABC Ltd*

- **SA 600**

- i. *When the principal auditor uses the work of another auditor, the principal auditor should determine how the work of the other auditor will affect the audit.*
- ii. *“Principal auditor” means the auditor with responsibility for reporting on the financial information of an entity when that financial information includes the financial information of one or more components audited by another auditor.*
- iii. *“Other auditor” means an auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial information audited by the principal auditor.*
- iv. *“Component” means a division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information audited by the principal auditor.*

- **Acceptance as Principal Auditor**

- v. *The auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor. For this purpose the auditor would consider:*
 - (a) *the materiality of the portion of the financial information which the principal auditor audits;*
 - (b) *the principal auditor's degree of knowledge regarding the business of the components;*
 - (c) *the risk of material misstatements in the financial information of the components audited by the other auditor; and*
 - (d) *the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.*

- **The Principal Auditor's Procedures**

- (1) *In certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so.*
- (2) *Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.*
- (3) *when planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India.*
- (4) *The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:*
 - a) *advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for coordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter component transactions that may require disclosure and the time-table for completion of audit; and*
 - b) *advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.*
- (5) *the principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.*
- (6) *the principal auditor may conclude that it is not necessary to apply procedures such as those described in paragraph 13 because sufficient appropriate audit evidence previously obtained that acceptable quality control policies and procedures are complied with in the conduct of other auditor's practice.*
- (7) *the principal auditor should consider the significant findings of the other auditor.*
- (8) *the principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor.*

“Auditing Q & A”

143. **Write short notes on coordination between principal auditor and other auditor.**

SA 600

- *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.*

144. **Discuss the reporting considerations of the principal auditor under SA600.**

- *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. (SA 600)*

145. **What aspects should be considered in the evaluation of internal Audit function? OR You have been appointed as auditor of a large industrial company which has an established internal audit department. You are required to state the main aspects you would consider to find out the effectiveness of the department. OR**

Enumerate, in brief, the important aspects to be evaluated by the external auditor in determining the efficiency and extent of reliance to be placed on the work and function of an internal auditor. OR The auditor needs to review the system of internal audit only when such review is required for the purpose of reporting by the auditor u/s 143 of the Act. Comment

• **SA 610**

- i. *The external auditor shall determine:*
 - a) *Whether the work of the internal auditors is likely to be adequate for purposes of the audit; and*
 - b) *If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the external auditor's procedures.*
- ii. *In determining whether the work of the internal auditors is likely to be adequate for purposes of the audit, the external auditor shall evaluate:*
 - a) *The objectivity of the internal audit function;*
 - b) *The technical competence of the internal auditors;*
 - c) *Whether the work of the internal auditors is likely to be carried out with due professional care; and*
 - d) *Whether there is likely to be effective communication between the internal auditors and the external auditor.*
- iii. *In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the external auditor's procedures, the external auditor shall consider:*
 - a) *The nature and scope of specific work performed, or to be performed, by the internal auditors;*
 - b) *The assessed risks of material misstatement at the assertion level for particular classes of transactions, account balances, and disclosures; and*
 - c) *The degree of subjectivity involved in the evaluation of the audit evidence gathered by the internal auditors in support of the relevant assertions.*

146. **How far is the internal audit useful to the statutory auditor? To what extent the statutory auditor can rely on the internal audit report? OR Can an auditor ignore checking of areas already checked by internal auditors? OR “The statutory auditor is entitled to rely on the internal auditor”. Comment OR Can the statutory auditor rely upon the work of an internal Auditor.**

“Auditing Q & A”

- **SA 610**

- a) *The external auditor shall determine:*
 1. *Whether the work of the internal auditors is likely to be adequate for purposes of the audit; and*
 2. *If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the external auditor's procedures.*
- b) *In determining whether the work of the internal auditors is likely to be adequate for purposes of the audit, the external auditor shall evaluate:*
 1. *The objectivity of the internal audit function;*
 2. *The technical competence of the internal auditors;*
 3. *Whether the work of the internal auditors is likely to be carried out with due professional care; and*
 4. *Whether there is likely to be effective communication between the internal auditors and the external auditor.*
- c) *In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the external auditor's procedures, the external auditor shall consider:*
 1. *The nature and scope of specific work performed, or to be performed, by the internal auditors;*
 2. *The assessed risks of material misstatement at the assertion level for particular classes of transactions, account balances, and disclosures; and*
 3. *The degree of subjectivity involved in the evaluation of the audit evidence gathered by the internal auditors in support of the relevant assertions.*
- d) *In order for the external auditor to use specific work of the internal auditors, the external auditor shall evaluate and perform audit procedures on that work to determine its adequacy for the external auditor's purposes.*
- e) *To determine the adequacy of specific work performed by the internal auditors for the external auditor's purposes, the external auditor shall evaluate whether:*
 1. *The work was performed by internal auditors having adequate technical training and proficiency;*
 2. *The work was properly supervised, reviewed and documented;*
 3. *Adequate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions;*
 4. *Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and*
 5. *Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.*

147. SA 620 Applies when an auditor seeks legal opinion from an advocate. Comment

- **SA 620**

1. *This Standard on Auditing (SA) deals with the auditor's responsibilities regarding the use of an individual or organization's work in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.*
2. *This SA does not deal with:*
 - a) *Situations where the engagement team includes a member with expertise in specialized area of accounting or auditing, which is dealt with in SA 220 (Revised); or*
 - b) *The auditor's use of the work of an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's expert), which is dealt with in SA 500 (Revised).*

148. How does an auditor evaluate the work of an expert? What are the auditor's duties vis a vis using the work of an expert?

- **SA 620**

If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert.

- **Nature, Timing and Extent of Audit Procedures**

The nature, timing and extent of the auditor's procedures with respect to the requirements in paragraphs 9-13 of this SA will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, the auditor shall consider matters including:

- (a) *The nature of the matter to which that expert's work relates;*
- (b) *The risks of material misstatement in the matter to which that expert's work relates;*
- (c) *The significance of that expert's work in the context of the audit;*
- (d) *The auditor's knowledge of and experience with previous work performed by that expert; and*
- (e) *Whether that expert is subject to the auditor's firm's quality control policies and procedures.*

“Auditing Q & A”

- **The Competence, Capabilities and Objectivity of the Auditor's Expert**

The auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.

- **Obtaining an Understanding of the Field of Expertise of the Auditor's Expert**

The auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to:

- (a) Determine the nature, scope and objectives of that expert's work for the auditor's purposes; and*
- (b) Evaluate the adequacy of that work for the auditor's purposes.*

- **Agreement with the Auditor's Expert**

The auditor shall agree, in writing when appropriate, on the following matters with the auditor's expert:

- (a) The nature, scope and objectives of that expert's work;*
- (b) The respective roles and responsibilities of the auditor and that expert;*
- (c) The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and*
- (d) The need for the auditor's expert to observe confidentiality requirements.*

- **Evaluating the Adequacy of the Auditor's Expert's Work**

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:

- (a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;*
- (b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and*
- (c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.*

If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall:

- (a) Agree with that expert on the nature and extent of further work to be performed by that expert; or*
- (b) Perform further audit procedures appropriate to the circumstances.*

- **Reference to the Auditor's Expert in the Auditor's Report**

The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the audit opinion.

149. ***The new audit trainee of your firm of auditors has asked you to advise him on the reliability of the evidence for valuation of land and buildings of Rs. 50 crores by a valuer. Describe the work you would carry out to check the independence, qualifications and experience of the valuer and the accuracy of the valuation. OR Based upon a legal opinion of a leading advocate, DX Ltd made a provision of Rs. 10 Crores towards income tax liability. The assessing authority has worked out the liability at Rs. 20 crores. It is observed that the opinion of the advocate was inconsistent with the legal position with regard to certain revenue items. Indicate the precise nature of auditor's liability in the above situation and support your views with authority, if any.***

1. Requirement under SA620:

- a) The auditor can seek audit evidence from an expert, either independently or in conjunction with the client.*
- b) Such audit evidence may be in the form of reports, opinions, valuations and other statements like legal opinions concerning interpretations of agreements, statutes, regulations, notifications, etc.*
- c) Where the expert's opinion is inconsistent with the provisions of law, then the auditor should deal with such inconsistency suitably. He may do it by discussing the issue with the Auditee client or the concerned expert.*
- d) However, the auditor should ensure that the expert's is prima facie dependable under the circumstances before relying upon the same.*

2. Application of SA620 to the above situation:

- a) The auditor should see that the advocate's opinion is prima facie dependable.*
- b) The situation described above clearly brings out the inconsistency of the opinion with the legal Provision with regard to certain items. Such inconsistency could have been detected and corrected if the auditor has sought assurance as to the appropriateness of the source data, assumptions involved therein and the methods adopted by the expert.*
- c) The auditor could have detected the inconsistency in legal opinions if he had gone through the same carefully. This is evident having regard to the wide difference in the liability worked out by the assessing authority.*
- d) Under the circumstances, the auditor should have rejected the opinion and insisted upon making proper provision.*

“Auditing Q & A”

3. **Conclusion:** The opinion is basically erroneous. Therefore, the auditor is liable for negligence and lack of due professional care in performance of the audit.

150. **LNK Ltd's Group Gratuity Scheme valuation by an actuary shows wide variation compared to the previous year's figures. What are the statutory auditor's duties? OR Swadesi Limited obtained an actuarial valuation for gratuity liability at this year-end. The actuary changed certain basic assumptions for working out the liability at this year end as compared to the ones adopted by him in the preceding year. State the auditor's responsibility in this matter.**

When an auditor's expert's work involves the use of significant assumptions and methods, factors relevant to the auditor's evaluation of those assumptions and methods include whether they are:

- Generally accepted within the auditor's expert's field;
- Consistent with the requirements of the applicable financial reporting framework;
- Dependent on the use of specialized models; and
- Consistent with those of management, and if not, the reason for, and effects of, the differences.

If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

151. **Briefly describe how an auditor can use the work of an expert.**

Using the Work of an Expert: SA 620 on, "Using the Work of an Expert" discusses the auditor's responsibility in relation to, and the procedures the auditor should consider in, using the work of an expert as audit evidence. The auditor has to first determine the need to use the work of an expert considering the materiality of the item, its nature and complexity. It would be necessary in cases of valuation of certain types of assets, determining the physical condition of the assets like minerals, actuarial valuation of gratuity, determining work in progress in case of construction contracts, etc. Generally, the auditor's education and experience enable him to be knowledgeable about business matters in general, but he is not expected to have the expertise of a person trained for, or qualified to engage in, the practice of another profession or occupation, such as an actuary or engineer.

When the auditor plans to use the expert's work as audit evidence, the auditor is required to assess skill and competence of the expert, his objectivity and, finally, evaluate the work done by him. So first of all, the auditor should satisfy himself as to the expert's skills and competence by considering the expert's:

- professional qualifications, license or membership in an appropriate professional body, and
- experience and reputation in the field in which the evidence is sought. .

However, when the auditor uses the work of an expert employed by him, he will not need to inquire into his skills and competence. The auditor should also consider the objectivity of the expert. Finally, 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 such other matters as:

- the objectives and scope of the expert's work,
- a general outline as to the specific items in the expert's report,
- confidentiality of the expert's work, including the possibility of its communication to third parties.
- the expert's relationship with the client, if any,
- confidentiality of the client's information used by the expert.

The auditor should seek reasonable assurance that the expert's work constitutes appropriate audit evidence in support of the financial information, by considering:

- the source data used,
- the assumptions and methods used and, if appropriate, their consistency with the prior period,
- the results of the expert's work in the light of the auditor's overall knowledge of the business and of the results of his audit procedures, and
- the auditor should also satisfy himself that the substance of the expert's findings is properly reflected in the financial information.

The auditor should consider whether the expert has used source data which are appropriate in the circumstances. The procedures to be applied by the auditor should include:

“Auditing Q & A”

- making inquiries of the expert to determine how he has satisfied himself that the source data are sufficient, relevant and reliable, and
- conducting audit procedures on the data provided by the client to the expert to obtain reasonable assurance that the data are appropriate.

The appropriateness and reasonableness of assumptions and methods used and their application are the responsibility of the expert. The auditor does not have the same expertise and, therefore, cannot always challenge the expert's assumptions and methods. However, the auditor should obtain an understanding of those assumptions and methods to determine that they are reasonable based on the auditor's knowledge of the client's business and on the results of his audit procedures.

If after performing all these procedures the auditor concludes that the work of the expert is not consistent with the information in the financial statements or that it does not constitute sufficient appropriate audit evidence, the auditor should express a qualified, disclaimer or an adverse opinion. In other cases, the opinion has to be unqualified. If while giving his report the auditor considers it appropriate to disclose the identity of the expert, he should obtain his prior consent.

152. **What are the different types of Opinion of an auditor in a Financial Statements? Explain briefly the different types of Opinion.**

- **Qualified Opinion:** The auditor shall express a qualified opinion when:
 - (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.
- **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- **Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

153. **What is Tax audit?**

The main Purpose of the tax audit is to compute the taxable income according to the law and for maintaining transparency in the financial statements filed by the assesses with the Income tax department.

- "A systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report."
- Under the existing provisions of section 44AB, every person carrying on business is required to get his accounts audited if the total sales, turnover or gross receipts in the previous year exceeds one crore rupees.

154. **Describe 'Voucher' and 'Vouching'.**

A voucher is a piece of substantiating evidence, in the form of a written record of expenditure disbursement, or completed transaction Examples of types of vouchers: Cash Memo, Sale Invoice. Purchase Requisition Slip, Purchase Invoice Gate Keeper's Note, Bank Paying Slip, Bank Statements. Minutes Book, etc

The act of examining all documentary evidences (vouchers) is referred to as vouching Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account. Vouching is said to be "the essence of auditing" or may be termed as the "Backbone of auditing"

- Importance of Vouching
 - (i) Serves as evidence, (ii) Assurance, (iii) Preliminary for Verification, (iv) Establishes Authenticity.

“Auditing Q & A”

155. What are the disqualifications for appointment of Statutory Auditor of a Company

Section 226 (3) provides that none of the following persons shall be qualified for appointment as auditor of a company

- i) A body corporate
- ii) An office; or employee of the company
- iii) A person who is a partner or who is in the employment of an officer or employee of the company
- iv) A person who is indebted to the company or has given any guarantee or provided any security connection with the indebtedness of any third person to the company for amount exceeding Rs. 1,000.
- v) A person holding any security of that company after a period of one year w.e.f. 13.12.2000.

It may be noted that if an auditor already holds appointment as auditor in the specified number or more of companies as per section 224(1B), he will be disqualified for being appointed as an auditor of any other company.

156. State the basic features and necessity of continuous Audit.

Basic features and scope of continuous audit.

- Basic features are:
 - 1) It is a process conducted throughout the year.
 - 2) It is conducted at regular or irregular intervals.
 - 3) It focuses on testing 100% of transactions.
 - 4) Technology is important to enabling it.
 - 5) It provides advance notice about errors and irregularities detected.
 - 6) Surprise visits by the auditor are involved.
- Necessity of continuous audit:

Continuous audit is necessary where:

 - 1) Internal controls are inadequate.
 - 2) The transactions run in large numbers.
 - 3) The management is interested in getting statements of accounts audited periodically for enabling better management of resources.

157. State the scope and advantages of Operational Audit.

Scope of Operational audit:

Operational audit, in its initial stages, was developed as a branch of internal auditing. Internal audit focuses on accounting operations of the entity. But operational audit has a wider scope of working and covers all other operations, such as production and marketing too.

- Advantage of operational audit:

Operational audit is one of the management tools to get first hand information. It is more useful in an entity where the management is at a distance from actual operation due to layers of delegation of responsibility. The management information system has various tools like routine performance report from department heads, internal audit reports, surprise checks, periodic inspections add investigation to control managers responsible for their departments. The operational audit is also one of the tools used in large or geographically vast entities to control the operation at first stage and to fill up the gaps of information provided by department heads through periodic reports.

158. What are the limitations of Internal Control?

Limitations of Internal control:

- (a) **Organizational structures:** Deficiencies in organizational structure make internal control ineffective.
- (b) **Size of the organization:** Small organizations have very low levels of internal control, which are almost negligible due to more interference by owners and management.
- (c) **Unusual transactions:** The internal control procedures normally fail to keep a check on unusual transactions.
- (d) **Costly:** The implementation of internal control procedures and processes involves incurring costs in terms of time, effort and resources.
- (e) **Abuse of power:** Members at the top level management may override/ interfere with control.
- (f) **Conclusion of two or more people.**
- (g) **Obsolescence**
- (h) **Potential for human error.**
- (i) **Frequent follow-up measures.**

“Auditing Q & A”

159. Discuss the role of C & AG in the Audit of Government Company.

Role of C&AG in the Audit of a Government company:

- The auditor of a government company is appointed by the C&AG. The C&AG have powers under section 619(3) of the Companies Act, 1956 as follows:
 - A) to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;
 - B) to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorize in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorized, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may by general or special order; direct.

In addition, the C&AG has a right to comment upon or supplement the audit report in such manner as he thinks fit.

160. State the parameters to be satisfied for issuing an unqualified audit report?

An unqualified audit report could be issued when the following parameters are met:

- i) **Evidence:** Reasonable evidence is obtained in support of transactions recorded in the books of account.
- ii) **Standards:** Accounting entries passed in the books of account are in conformity with the generally applicable accounting principles and Accounting standards followed consistently.
- iii) **True and Fair:** The financial statements prepared represent a true and fair summary of the transactions that took place during the year.
- iv) **Classification:** The process of classification and aggregation followed in the preparation of the financial statements is fair and it does not hide a material fact nor does it highlight something, which may distort the real state of affairs.
- v) **Format:** The form of financial statement is in accordance with the form prescribed by law, if any.
- vi) **Free of misstatements:** There are no material misstatements in the financial statements. No material transaction recorded in the books of account is illegal or beyond the legal competence of the company.

161. Explain the significance of audit working papers.

Working Papers are necessary to -

- (a) Aid in planning and performance of the audit,
- (b) Aid in the supervision and review of the audit work,
- (c) Provide evidence of the audit work performed to support the Auditor's opinion,
- (d) Record and demonstrate the audit work from one year to another,
- (e) Plan the timing and extent of audit procedures to be performed,
- (f) Draw conclusions from the evidence obtained,
- (g) Standardize the Working Papers and audit procedures to improve the efficiency of the audit,
- (h) Facilitate the delegation of work as a means to control quality of work performed,
- (i) Provide guidance to the audit staff with regard to the manner of checking the schedules,
- (j) Fix responsibility on the staff member who signs each schedule checked by him, and
- (k) Act as evidence in a Court of law when a charge of negligence is brought against the auditor.

162. What is cut off procedure? Explain its significance in the context of Auditing

Cut off procedure would mean a procedure adopted to give a delink between two time periods prompted by accounting procedure or a legal requirement. Example: Date of accounting closing to ascertain the profit or loss - for accounting procedure. Ascertain the profits between pre and post incorporation periods - legal requirement. Possible areas where cut off procedure has significant impact is given below:

- (a) Accounts receivable and accounts payable these are the most susceptible to recording of transactions in the inappropriate accounting period.
- (b) Purchase bills or rising of sales invoice which requires to be linked to the accounting period for determining the profit or loss of the period.

It is the auditor's duty to examine cut off points and ensure that the transactions are recorded in the relevant period in which the commercial transactions relate to or take place.

163. List the steps involved in internal control

An effective internal control system consists of certain important steps, which are:

“Auditing Q & A”

- **Control Environment:** Establish Integrity & ethical value.
- **Assessment of Risk:** Establishment of plan to prevent risks.
- **Control Activities:** Formulating policies & procedures.
- **Information & communication:** Evaluation of employee performance.
- **Monitoring:** Assessing overall performance of the Organisation.

164. **List any two differences between Financial Audit and Management Audit.**

<u>Financial Audit</u>	<u>Management Audit</u>
Examination of Financial Statements to express an opinion thereon.	Review of the decisions and actions of Management to analyse performance.
Generally propriety aspect is not considered in detail.	Propriety and efficiency of decisions and managerial actions are studied.

165. **Vouch foreign travelling expenditure of a Director and list any two issues.**

Following are the two issues related to the vouching of foreign travelling expenditure of a Director:

- **Visa for travel :** which shows the purpose of travel.
- **Amount of Foreign exchange :** Sanctioned for the travel including the authenticity/jurisdiction of the sanctioning authority. Sanction given by the board , if any

166. **List the disadvantages of Joint Audit.**

The following may be the disadvantages of a joint audit:

- Sharing of fees;
- Psychological problem, where firms of different standing are associated in Joint audits;
- Superiority complex of some auditors may affect the work of co-auditor;
- Problem arises regarding co - ordination of the work;
- Areas of work of common concern being neglected;
- Uncertainty about the liability for the work done.

167. **Differentiate between Physical Verification and Confirmation.**

In the process of audit if the auditor is provided with any information that the quality and the value of say, stock is appropriate , by the management of the company then the auditor relies on their statement and prepares his report based on that information. In this case it means the auditor has received the confirmation from the management and there is no liability of the auditor for any mistake in this regard. On the other hand if the auditor has to physically verify the stock and then again he has to verify the records personally, that will be a case of Physical Verification. In this case if there is any mismatch between the two the reconciliation statement is prepared.

168. **State the procedure for removal of statutory auditor before the expiry of his term as per Companies Act, 2013.**

Removal of auditor before expiry of his term [Section 140(1) of Companies Act, 2013]:

- a) **Resolution :** Such removal requires a special resolution.
- b) **Approval:** Previous approval of the Central Government must be obtained in the manner prescribed.
- c) **Procedure for obtaining approval of the Central Government and passing Special Resolution (Rule 7).**
 - (i) An application shall be made to the Central Government in Form ADT-2. The application shall be accompanied with the prescribed fees.
 - (ii) The application shall be made to the Central Government within 30 days of passing of the Board resolution.
 - (iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.
- d) **Opportunity of being heard:** Before taking any action for removal, the auditor shall be given a reasonable opportunity of being heard.

“Auditing Q & A”

169. **Distinguish between Principles & Techniques of Auditing.**

<u>Principles of Auditing</u>	<u>Techniques of Auditing</u>
<i>It refers to the fundamental considerations that sustain the function of auditing and direct its activities.</i>	<i>It refers to the methods and means adopted by the Auditor for collection and evaluation of audit evidence in different auditing situations.</i>
<i>As listed in SA - 200, these are -</i> <i>(a) Integrity, Objectivity & Independence,</i> <i>(b) Confidentiality,</i> <i>(c) Skills and Competence,</i> <i>(d) Work performed by others,</i> <i>(e) Documentation,</i> <i>(f) Planning,</i> <i>(g) Audit Evidence,</i> <i>(h) Accounting System & Internal Control,</i> <i>(i) Audit Conclusions and Reporting.</i>	<i>These are not listed exhaustively. Some examples are -</i> <i>(a) Physical Inspection (of Fixed Assets),</i> <i>(b) Confirmation (of Debtors Balances),</i> <i>(c) Inquiry (on Accounting Systems),</i> <i>(d) Calculation of Ratios (GP Ratio, NP Ratio).</i>
<i>The principles are not liable to change frequently.</i>	<i>Audit techniques may vary according to the nature of propositions to be tested.</i>
<i>They do not vary with time.</i>	<i>The techniques to be adopted vary with the time / period of auditing.</i>
<i>Principles of auditing remain the same irrespective of the nature of the Firm.</i>	<i>They may vary from Firm to Firm depending upon the nature of business, number of transactions, etc.</i>

170. **Discuss the qualities a management auditor should possess.**

The management auditor should possess the following qualities:

- i. *Ability to understand the nature and objectives and problems faced by the organisation.*
- ii. *He should have general understanding of different laws and regulations like Tax Laws, Company Laws etc.*
- iii. *Expert knowledge of management principles such as delegation of authority, management by exception, budgetary control, flow charts, etc.*
- iv. *Sufficient knowledge and experience in preparing and presenting reports to different levels of management.*
- v) *Working knowledge of engineering, costing, statistics, management accounting, industrial psychology etc.*
- vi) *Dynamic, tactfulness and a pleasing personality.*

171. **Discuss how Cost Audit is useful to Management, society, Shareholders and Government?**

The major advantage of Cost Audit, to various categories of persons, is as under :-

- **To Management:**
 - (i) *Reliability of date for day-to-day operations like determination of price, cost control, decision making etc.*
 - (ii) *Continuous check on all wastages through a proper system of reporting.*
 - (iii) *Highlighting of inefficiencies in operations, in order to take corrective action.*
 - (iv) *Adoption of management by Exception through allocation of responsibilities to individual managers.*
 - (v) *Introduction of a system of Budgetary Control and Standard Costing.*
 - (vi) *Establishment of reliable check on the valuation of Closing Stock and Work-in-Progress.*
 - (vii) *Detection and prevention of errors and fraud.*
- **To the Society:**
 - (i) *Proper pricing on the basis of correct costing data saves consumer from exploitation.*
 - (ii) *Consumers can maintain their standard of living, since price increase by the industry is not allowed without proper justification like, increase in cost of materials, labour, etc.*

To Shareholders: Cost Audit benefits the shareholders by ensuring that –

 - (i) *Proper records are kept for purchases, utilization of materials, expenses incurred on wages, OH, etc.*
 - (ii) *The enterprise has been run economically and efficiently.*
 - (iii) *A fair return on investment is determined by proper determination of costs.*

“Auditing Q & A”

- To The Government:
 - (i) To fix the price of cost-plus contracts, wherever applicable.
 - (ii) To fix selling price of essential commodities and therefore check undue profiteering.
 - (iii) To focus its attention on inefficient units.
 - (iv) To decide on granting of protection to certain industries based on their needs.
 - (v) To settle trade disputes brought to the Government.
 - (vi) To impose automatic check on inflation by promoting healthy competition among industries.

172. **Discuss the process of Audit in Depth.**

The process of examination in depth explains its meaning and importance. It is stated as under:

- i. *Fixation of the maximum tolerable error limit/desired confidence level.*
- ii. *Selecting a few transactions in each area of audit to be checked.*
- iii. *Verification of those selected transactions- 100% by verifying the accounting aspects, internal control aspects, documentation and audit trail.*
- iv. *Audit trail refers to the documents, records, books and files, which enable an auditor to trace a transaction from its source till it is summed up, recorded and presented in an accounting report.*
- v. *Analysis of the results with the maximum tolerable error limit.*

173. **Propriety audit is applicable to all limited companies in all aspects.**

A propriety audit is not just concerned with the truthfulness and fairness of the Financial Statements and books of accounts of the client, but also ensures that the transactions entered into by the client, business practices and activities undertaken are not against public interest. Its objective is to see that the business lives upto standards of proper conduct. Legal, economic and financial are all equally important aspects that require to be looked into during the course of the audit.
