PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

(Legislative Amendments as per the Companies Act, 2013)

1. Payments controlled by the Companies Act, 2013:

   (a) Under section 180, the Board of Directors of a company except with the consent of the company by a special resolution exercises the following powers.

   (i) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.

   (ii) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;

   (iii) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business:

   Provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

   (iv) to remit, or give time for the repayment of, any debt due from a director.

   (b) Under section 181, the Board of Directors of a company can contribute to the bonafide charitable and other funds any amount in any financial year. Prior permission of the company in general meeting is required in case if the aggregate of such contribution exceeds 5% of its average net profits for the three immediately preceding financial years.

   (c) Section 182 deals with prohibition and restriction regarding political contributions. According to this section, a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party. In other cases, contribution in any financial year should not exceed 7½ % of average net profits during the three immediately preceding financial years.

   (d) Section 183 permits the Board and other person to make contributions to the National Defence Fund or any other Fund approved by the Central Government for the purpose of National Defence to any extent as it thinks fit.

2. Allotment of shares and receipt of Allotment: (Section 39 of the Companies Act, 2013)

(i) Examine Director's Minutes Book to verify approval of allotments.

(ii) Compare copies of letters of allotment with entries in the Application and Allotment Book.

(iii) Trace entries in the Cash book into the Application and Allotment Book for the verification of amounts collected on allotment.

(iv) Trace the amount collected on application as well as those on allotment from the Application and Allotment Book into the Share Register.

(v) Check whether the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on such application have been received by the company.

(vi) Check that the amount payable on the application on every security is not less than five percent of the nominal amount of security or such other percentage or amount as may be prescribed by the SEBI.

(vii) If the stated minimum amount has not been subscribed and the sum payable on subscription is not received within a period of thirty days from the date of issue of the prospectus or such period as my be specified by the SEBI, check that the amount received above is returned within a period of fifteen days from the closure of the issue and if in case the amount is not repaid within such period, the directors in default shall jointly and severally be liable to repay that amount with interest at the rate of fifteen percent per annum.

(viii) Check totals of amounts payable on allotment and verify the journal entry debiting Share Allotment Account and crediting Share Capital Account.

3. Prohibition for buy back in certain circumstances : Section 70 of the Companies Act, 2013.

(1) No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank, is subsisting. Provided that the buy – back is not prohibited if the default is remedied and a period of three years has elapsed since the cessation of the default.

(2) No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92,123, 127 and 129. Section 92 relates to the filing of Annual Return, Section 123

and 127 to declaration and payment of dividend and Section 129 to the financial statement of the company.

4. Central Government to prescribe Accounting Standards (Section 133 of the Companies Act, 2013): Section 133 of the Companies Act, 2013 provides the provisions for Central Government to prescribe accounting standards. According to section 133 of the Companies Act, 2013:

   "Accounting Standards" means the standards of accounting or any addendum thereto as recommended by the Institute of Chartered Accountants of India (ICAI) constituted under section 3 of the Chartered Accountants Act, 1949, as may be prescribed by the Central Government in consultation with and after examination of the recommendations made by the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013.

   In respect of accounting standards, the role of National Financial Reporting Authority is limited to advise the Central Government on the accounting standards recommended by ICAI for adoption by companies.

   The Ministry of Corporate Affairs (MCA) vide General Circular No. 15/2013 dated 13th September, 2013 has clarified that till the Standards of Accounting or any addendum thereto are prescribed by Central Government in consultation and recommendation of the National Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act, 1956 shall continue to apply.

5. Payment of Dividend in proportion to amount paid-up (Section 51 of the Companies Act, 2013): A company, if so authorised by its Articles, may pay dividend in proportion to the amount paid-up on each share.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

1. State with reason (in short) whether the following statements are true or false:

   (i) The principle of confidentiality precludes auditor to disclose the information about the client to a third party at all circumstances without any exception.

   (ii) It is no part of subsequent auditor's duty to verify opening balances of Ledger accounts of current years, on the basis of Balance Sheet audited by Previous Auditor.

   (iii) AS 10 "Accounting for Fixed Assets" is also applicable to wasting assets like quarries, minerals, oil and natural gases.

   (iv) When Government grants are received in the form of assets such as land, plant and equipments etc., free of cost, then, such assets should be entered in the books of accounts at nominal value.

(v) Confirmations received by the auditor directly from third parties are conclusive evidence in support of a transaction.

(vi) A branch auditor is a joint auditor according to SA 299 and his relationship with the company auditor is governed by the said Standard.

(vii) Branch auditor of a company should give photocopies of his working papers on demand by Company Auditor.

(viii) Events occurring after the balance sheet date must be disclosed in the financial statements.

(ix) When an auditor identifies a Misstatement resulting from fraud, it is his responsibility to communicate it to the regulatory and enforcement authorities apart, from those charged with governance.

(x) Internal check is part of internal control system.

2. Discuss with reference to SAs:

(a) While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?

(b) What are the auditor's responsibilities in respect of corresponding figures?

(c) IT systems also pose specific risks to an entity's internal control. What are those risks?

Nature of Auditing

3. (a) Discuss the types of audits required under law.

(b) What are the inherent limitations of audit?

4. As a Statutory Auditor, how would you deal with the following?

(a) The Managing Director of the Company has committed a "Teeming and Lading" Fraud. The amount involved has been however subsequently after the year end deposited in the company.

(b) The accountant of C Ltd. has requested you, not to send balance confirmations to a particular group of debtors since the said balances are under dispute and the matter is pending in the court.

Basic Concepts in Auditing

5. What are the obvious assertions in the following items appearing in the Financial Statements?

(a) Profit and Loss Statement

Travelling Expenditure	₹ 50,000

(b) Balance Sheet

Trade receivable	₹ 2,00,000

6. (a) What are Audit working papers and why should they be carefully preserved by the Auditor?

   (b) Explain the advantages of "Audit Working Papers".

7. (a) What is “Audit Evidence”?

   (b) What are the various methods of obtaining audit evidence? Mention the same in brief.

   (c) Discuss the principles, which are useful in assessing the reliability of audit evidence.

Preparation for an Audit

8. (a) Explain concept of materiality and factors which act as guiding factors to this concept.

   (b) Describe a set of instructions, which an auditor has to give to his client before the start of actual audit.

9. Write short notes on the following:

   (a) Reliability of external confirmations.

   (b) Factors governing modes of communication of auditor with those charged with governance.

   (c) Procedures to be performed by the auditor in expressing opinion on 'going concern' assumption.

Internal Control

10. In a medium size trading organisation the accountant was given additional responsibility of making recoveries from the trade receivables. On one occasion, when an insurance claim of ₹ 25,000 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. Comment.

11. (a) Why are Computer Aided Audit Techniques (CAAT) required in EDP audit?

    (b) What are the advantages of CAATs?

Vouching & Verification of Assets and Liabilities

12. (a) What procedure an auditor should adopt to test the authenticity of cash at bank?

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

13. How will you verify/vouch the following:

    (a) Sale proceeds of Scrap Material.

    (b) Trade Marks and Copyrights.

(c) Machinery acquired under Hire-purchase system.

(d) Work-in-progress.

14. XYZ Ltd. Co. gave a donation of ₹ 50,000 each to a Charitable Society running a school and a trust set up for the service of Blind during financial year ending on 31st March, 2014. The average net profits of the company for the last three years were 15 lakhs. Comment.

The Company Audit

15. (a) Under what circumstances the retiring Auditor cannot be reappointed?

(b) Explain the concept of joint audit. Discuss its advantage and disadvantage.

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

(a) The sale and purchases of investments of A Ltd., was controlled through a committee. Shri B sold some of the investments without discussing the same with the other members of the committee as they were out of station and Shri B believed that its price would fall and the company would suffer a loss if it is not sold. A Ltd. earned a profit of ₹ 1 lakh from such sale.

(b) The company due to liquidity crises sold and leased back the same vehicles from leasing companies. In the notes to accounts, the company stated 'Vehicles taken on lease repayable in 46 instalments of ₹ 26,650 each'.

(c) No depreciation provided on a machinery costing ₹ 50 lakhs imported three years back, since it is yet to be put into use.

17. (a) State the basic elements of the Auditor's Report.

(b) When does an auditor issue unqualified opinion and what does it include?

18. As an auditor, how will you verify application and allotment money received on shares issued for cash?

Special Audits

19. (a) State any five special points which you, as an auditor, would look into while examining the income and collection of fund by an NGO engaged in providing relief work for flood victims.

(b) You are approached by a partnership firm to list out the advantages that will accrue to them, if the accounts are audited. State five important advantages.

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

(i) Audit against Rules and Orders

(ii) Audit of Sanctions

(iii) Audit against Provision of Funds

(iv) Propriety Audit

(v) Performance Audit

SUGGESTED ANSWERS / HINTS

1. (i) False: The principle of confidentiality is one of the basic principles of auditing. Auditor is generally not expected to disclose the information of his client to others. But it is not the case always. He can disclose the information to others if (a) permitted by his client or (b) he has to disclose it as per any statutory obligation dictated by any law.

(ii) False: According to SA 510 “Initial Audit Engagements - Opening Balances”, it is the responsibility of the auditor to verify and obtain appropriate evidence in respect of opening balances brought forward from the preceding period.

(iii) False: AS 10 “Accounting for Fixed Assets” clearly states that this Accounting Standard is not applicable to wasting assets like quarries, minerals oil and natural gas.

(iv) True: According to AS 12 “Accounting for Government Grants ” when Government grants in the form of non-monetary assets such as land, plant and equipments etc. are received free of costs then such assets should be entered in the books of account at nominal value.

(v) False: Confirmations received directly from the third parties by the auditor are more reliable but same cannot be treated as conclusive evidence.

(vi) False: Branch auditor is not a joint auditor within the meaning of SA 299. He is another auditor within the meaning of SA 600.

(vii) False: As per SA 230 on “Audit Documentation”, 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 of his personnel.

Main auditor does not have right of access to the working papers of the branch auditor. In the case of a company, the main auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch but cannot ask for the copy of working papers and therefore, the branch auditor is under no compulsion to give photocopies of his working papers to the principal auditor of the Company.

(viii) False: As per AS-4 on "Contingencies and Events Occurring After the Balance Sheet Date", Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

(ix) True: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" an auditor identifies a misstatement resulting from fraud or error it is his responsibility to communicate the matter with those charged with the governance and, in some circumstances, when so required by laws or regulations, to regulatory and enforcement authorities also.

(x) True: Internal check has been defined as "checks on day-to-day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". Internal check is a part of the overall internal control system and operates as a built-in device as far as the staff organisation and job allocation aspects of the control system are concerned.

2. (a) Risk Factors while applying sampling techniques: As per SA 530(Revised) "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions.

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exists when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatements exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

(b) Auditor's responsibilities in respect of corresponding figures: As per SA 710 "Comparative Information—Corresponding Figures and Comparative Financial Statements", in respect of corresponding figures, the auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

(i) The comparative information agrees with the amounts and other disclosures presented in the prior period; and

(ii) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 "Subsequent Events".

As required by SA 580, "Written Representations", the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss.

(c) Specific Risk to an Entity's internal Control: As per SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", IT system also poses specific risks to an entity's Internal Control. They are–

(i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both

(ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non existent transactions, or inaccurate recording of transactions. Particular risk may arise when multiple users access a common database.

(iii) The possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.

(iv) Unauthorised changes to data in Master files

(v) Unauthorised changes to systems or programs.

(vi) Failure to make necessary changes to systems or programs.

(vii) In appropriate manual intervention

(viii) Potential loss of data or inability to access data as required.

3. (a) Audits required under Law: Audit is not legally obligatory for all types of business organisations or institutions. On this basis audits may be of two broad categories i.e., audit required under law and voluntary audits.

The organisations which require audit under law are the following:

(i) Companies governed by the Companies Act;

(ii) Banking companies governed by the Banking Regulation Act, 1949;

(iii) Electricity supply companies governed by the Electricity Supply Act, 1948;

(iv) Co-operative societies registered under the Co-operative Societies Act, 1912;

(v) Public and charitable trusts registered under various Religious and Endowment Acts;

(vi) Corporations set up under an Act of Parliament or State Legislature such as the Life Insurance Corporation of India.

(vii) Specified entities under various sections of the Income-tax Act, 1961.

(viii) Audit required under Sales-tax and VAT by various State Government.

(b) **Inherent limitations of Audit:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the objectives of an audit of financial statements, prepared with in a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements. In forming his opinion on the financial statements, the auditor follows procedures designed to satisfy him that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The process of auditing, however, is such that it suffers from certain limitations, i.e. the limitation which cannot be overcome irrespective of the nature and extent of audit procedures. The limitations of an audit arise from:

(i) The Nature of Financial Reporting: The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures.

(ii) The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.

2. Fraud may involve sophisticated and carefully organised schemes designed to conceal it. The auditor is neither trained as nor expected to be an expert in the authentication of documents.

3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

(iii) Timeliness of Financial Reporting and the Balance between Benefit and Cost: The relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

(iv) Other Matters that Affect the Limitations of an Audit: In the case of certain assertions or subject matters, the potential effects of the limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

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

4. (a) Fraud Committed by Managing Director: The Managing Director of the company has committed a "Teeming and Lading" fraud. The fact that the amount involved has been subsequently deposited after the year end is not important because the auditor is required to perform his responsibilities as laid down in SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements". First of all, as per SA 240, the auditor needs to perform procedures whether the financial statements are materially misstated. Because an instance of fraud cannot be considered as an isolated occurrence and it becomes important for the auditor to perform audit procedures and revise the audit risk assessment. Secondly, the auditor needs to consider the impact of fraud on financial statements and its disclosure in the audit report. Thirdly, the auditor should communicate the matter to the Chairman and Board of Directors. Finally, in view of the fact that the fraud has been committed at the highest level of management, it affects the reliability of audit evidence previously obtained since there is a genuine doubt about representations of management. Finally, the auditor shall have to report

under CARO, 2003 indicating the nature and amount involved in respect of fraud noticed during the year.

(b) External confirmation Requests: SA 505, "External Confirmations", establishes standards on the debtor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management.

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

(i) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;

(ii) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and

(iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with "SA 260 Communication with Those Charged with Governance". The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with "SA 705 Modifications to the Opinion in the Independent Auditor's Report".

5. (a) Travelling Expenditure: ₹ 50,000

- Expenditure has been actually incurred for the purpose of travelling.
- Travelling has been undertaken during the year under consideration.
- Total amount of expenditure incurred is ₹ 50,000 during the year.
- It has been treated as revenue expenditure and charged to profit and loss account.

(b) Trade receivable: ₹ 2,00,000

- These include all sales transaction occurred during the year.
- These have been recorded properly and occurred during the year
- These constitute assets of the entity.

These have been shown at proper value, i.e. after showing the deduction on account of provision for bad and doubtful debts.

6. (a) **Audit Working Papers:** As per SA 230(Revised) "Audit Documentation", audit Working Papers are the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

Working papers are the

(i) Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor; and

(ii) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Besides they serve a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, provides that, unless otherwise specified by law or regulation, working papers are the property of the auditor. He may at his discretion, make portions of, or extracts from, working papers available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel

Retention of working papers: Working papers should be retained, long enough, for a period of time sufficient to meet the needs of his practice and satisfy any legal or professional requirement of record retention. SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

(b) Audit working papers constitute the basic records for the auditor in respect of the audit carried out by him. They constitute the link between the auditor's report and clients' record.

These include retention of permanent record in the nature of a document to show the actual audit work executed the nature of the, work, the extent of the work and important points, facts, dates and decisions having bearing on the audit of the accounts audited. The working papers, if properly maintained, can be used as defense in case of need. The audit working papers are found very useful in the following aspects as they:

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

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

(iii) provide evidence of the audit work performed to support the auditor's opinion; and

(iv) act as an evidence in the Court of law when a charge of negligence is brought against the auditor.

7. (a) Audit Evidence: As per SA 500 "Audit evidence" Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

(b) Methods of Obtaining Audit Evidence: The auditor obtains evidence by one or more of the following methods:

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

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

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

Observation: Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

External Confirmation: An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a "side agreement" that may influence revenue recognition.

Recalculation: Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Reperformance: Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures: Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

Inquiry: Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

(c) **Reliability of Audit Evidence:** The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).

Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

8. (a) **Concept of materiality:** SA 320 "Materiality in Planning and Performing an Audit", establishes standards on the concept of materiality and the relationship with audit risk while conducting an audit. Hence, the auditor requires more reliable evidence in support of material items. SA 320 defines material items as relatively important and relevant items, i.e., items the knowledge of which would influence the decision of the user of financial statements. Financial statements materially affect if such statement is erroneously stated or omitted to be stated there in and economic decision of the users taken on the basis of such information is influenced by such misstatements or omissions.

The auditor has to ensure that such items are properly and distinctly disclosed in the financial statements.

The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not.

There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

Factors to be considered for determining materiality

(i) Item of materiality may be determined individually or in aggregate.

(ii) The materiality depends on the regulatory or legal considerations.

(iii) Materiality is not often reckoned with respect to quantitative details above. It has qualitative dimensions as well.

(iv) Even insignificant items in terms of quality may be material in special circumstances.

(v) Sometimes the materiality of an item in terms of quantity is described in law itself. For example, Schedule III requires disclosure of items of expenditures which are in excess of one percent or ₹ 1,00,000 whichever is higher.

(vi) An item whose impact is insignificant at present, but in future it may be significant, may be material item.

(b) Following instructions are given by the auditor to the client before the start of audit:

(i) The accounts should be total up and trial balance and final accounts to be kept ready.

(ii) Vouchers should be serially arranged.

(iii) Schedule of trade receivables and trade payables should be prepared.

(iv) Schedule of outstanding expenses, prepaid expenses and accrued income to be kept ready.

(v) A list of bad and doubtful debts should be prepared.

(vi) Schedule of investments should be prepared.

(vii) Certified list of goods returned to be prepared.

(viii) Statement of permanent capital expenditure to be prepared.

(ix) Schedule of deferred revenue expenditures to be prepared.

(x) Names and addresses of managers and other officers should be kept ready.

9. (a) **Reliability of external confirmations:** As per SA 505 "External Confirmation", the reliability of external confirmations depends among other factors, upon the application of appropriate procedures by the auditor in designing the external confirmation request, performing the external confirmation procedures, and evaluating the results of the external confirmation procedures.

The factors that affect the reliability of confirmations include:

(i) The control which the auditor exercises over confirmation request and responses;

(ii) The character of respondents and

(iii) Any restrictions included in the response or imposed by the management

(b) **Factors governing modes of communication of auditor with those charges with governance :** As per SA 260, "Communication with Those Charge with Governance" the auditor may decide whether to communicate orally or in writing, the extent of detail or summarisation in the communication, and whether to communicate in a structured or unstructured manner) may be affected by such factors as:

(i) The size, operating structure, control environment, and legal structure of the entity.

(ii) In the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.

(iii) Legal requirements. In some jurisdictions, a written communication with those charged with governance is required in a prescribed form by local law.

(iv) The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.

(v) The amount of ongoing contact and dialogue the auditor has with those charged with governance.

(vi) Whether there have been significant changes in the membership of a governing body

(c) **Procedures to be performed by the auditor in expressing opinion on 'going concern' assumption:** As per SA 570, "Going Concern", the following are the relevant procedures that are relevant in this connection:

- Analyse and discuss cash flow, profit and other relevant forecasts with management.
- Review events after the balance sheet date for items affecting the entity's ability to continue as a going concern.

- Analyse and discuss the entity's latest available interim financial statements.
- Review the terms of debentures and loan agreements and determine whether any have been breached.
- Read minutes of the meetings of shareholders, the board of directors and important committees for reference to financing difficulties.
- Review the status of matters under litigation and claims.
- Confirm the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assess the financial ability of such parties to provide additional funds.
- Consider the entity's position concerning unfilled customer orders.

10. Following two essential features of internal control are relevant here:

    (i) 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

    (ii) 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.

11. (a) Computer Aided Audit Techniques (CAATs): The use of computers may result in the design of systems that provide less visible evidence than those using manual procedures. CAATs are such techniques applied through the computer which are used in the verifying the data being processed by it. System characteristics resulting from the nature of EDP processing that demand the use of Computer Aided Audit Techniques (CAAT) are:

    (i) *Absence of input documents*: Data may be entered directly into the computer systems without supporting documents. In on-line transaction systems, written evidence of individual data entry authorization, e.g., credit limit approval may not be available.

    (ii) *Lack of visible transaction trail*: Certain data may be maintained on computer files only. In a manual system, it is normally possible to follow a transaction through the system by examining source documents, books of account, records, files and reports. In an EDP environment, however, the transaction trail may be partly in machine-readable form, and it may exist only for a limited period of time.

(iii) *Lack of visible output*: In a manual system, it is normally possible to examine visually the results of processing. In EDP systems, the results of processing may not be printed or only a summary data may be printed. Thus, the lack of visible output may result in the need to access data retained on machine readable files.

(iv) *Ease of Access to data and computer programmes*: Data and computer programmes may be altered at the computer or through the use of computer equipment at remote locations. Therefore, in the absence of appropriate controls, there is an increased potential for unauthorized access to, and allocation of, data and programmes by persons inside or outside the entity.

(b) Advantages of CAAT:

(i) *Audit effectiveness*: The effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence, for example –

(a) Some transactions may be tested more effectively for a similar level of cost by using the computer.

(b) In applying analytical review procedures, transactions or balance details of unusual items may be reviewed and reports got printed more efficiently by using the computer.

(ii) *Savings in time*: The auditor can save time by reviewing the EDP controls using CAAT than through other audit procedures.

(iii) *Effective test checking and examination in depth*: CAAT permits effective examination in depth of selected transactions since the auditor constructs the lost audit trail.

12. (a) Verification of Cash at Bank: While testing the authenticity of cash at bank, the following areas may be considered by the auditor:

(i) Apart from comparing the entries in the cash book with those in the Pass Book the auditor should obtain a certificate from the bank confirming the balance at the close of the year as shown in the Pass Book.

(ii) Examine the bank reconciliation statement prepared as on the last day of the year and see whether (a) cheques issued by the entity but not presented for payment, and (b) cheques deposited for collection by the entity but not credited in the bank account have been duly debited/credited in the subsequent period.

(iii) Pay special attention to those items in the reconciliation statements which are outstanding for an unduly long period. The auditor should ascertain the reasons for such outstanding items from the management. He should also examine whether any such items require an adjustment write-off.

(iv) Examine relevant certificates in respect of fixed deposits or any type of deposits with banks duly supported by bank advices.

(v) The auditor should examine the possibility, that even though the balance in an apparently inoperative account may have remained stagnant, transactions may have taken place in that account during the year.

(vi) In relation to balances/deposits with specific charge on them, or those held under the requirements of any law, the auditor should examine that suitable disclosures are made in the financial statements.

(vii) Remittances shown as being in transit should be examined with reference to their credit in the bank in the subsequent period. Where the auditor finds that such remittances have not been credited in the subsequent period, he should ascertain the reasons for the same. He should also examine whether the entity has reversed the relevant entries in appropriate cases.

(viii) The auditor should examine that suitable adjustments are made in respect of cheques which have become stale as at the close of the year.

(ix) Where material amounts are held in bank accounts which are blocked, e.g. in foreign banks with exchange control restrictions or any banks which are under moratorium or liquidation, the auditor should examine whether the relevant facts have been suitably disclosed in the financial statements. He should also examine whether suitable adjustments on this account have been made in the financial statements in appropriate cases.

(x) Where the auditor finds that the number of bank accounts maintained by the entity is disproportionately large in relation to its size, the auditor should exercise greater care in satisfying himself about the genuineness of banking transactions and balances.

(b) Cheques Received on the last day of Accounting Year: It is a quite normal that in any ongoing business entity many a times cheques are received from the customers on the last day of the accounting year. It is also quite likely, that cheques received on the last day of the accounting year could not be deposited in the bank. Though normally speaking, it is expected that all cheques should be deposited in the bank daily. But there may be a possibility that such cheques which are received particularly during the late hours could not be deposited in the bank. Therefore, it is quite important to ensure that the system of internal control is effective and such cheques should be properly accounted for to avoid any frauds and that the financial statements reflect a true and fair view.

As far as internal control system is concerned, it should be ensured that a list of such cheques is prepared in duplicate and a copy of the same has been sent to person controlling the trade receivables' ledger and a second copy is handed over to cashier along with the cheques received. The person who is controlling the trade receivables' ledger should ensure that proper accounting entries have been passed by crediting respective trade receivables' accounts. The balance of cheques-in-hand should also be disclosed along with the cash and bank balances in the financial statements.

13. (a) Sale Proceeds of Scrap Material

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

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

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

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

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

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

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

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

(b) Trade Marks and Copyrights

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

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

(iii) Verify existence of copyright by reference to contract between the author and the entity and check the payment of royalty made to author.

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

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

(vi) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations, as per the principles enunciated under AS 26 on Intangible Assets.

(c) Machinery acquired under Hire-purchase system

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

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

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

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

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

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

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

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

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

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

(v) Ensure that the Work-in-Progress as at Balance Sheet date has been appropriately disclosed in Balance Sheet as per the requirements of Part I of Schedule VI of the Companies Act.

14. Donation to Charitable Institutions: Section 181 of the Companies Act, 2013 provides that the Board of Directors of a company may contribute to bona fide charitable and other funds with prior permission of the company in general meeting for such contribution in case any amount the aggregate of which, in any financial year, exceed five per cent of its average net profits for the three immediately preceding financial years.

Facts of the case: In the instant case, the company has given donation of ₹ 50,000/- each to the two charitable organisations which amounts to ₹ 1,00,000. Assuming that the charitable organisations are not related to the business of the company, the average profits of the last 3 years is ₹ 15 lakhs and the 5% of this works out to ₹ 75,000. Hence the maximum of donation could be ₹ 75,000 only. For excess of ₹ 25,000 the company is required to take prior permission in general meeting which is not been taken.

Conclusion: By paying donations of ₹ 1,00,000 which is more than ₹ 75,000, the Board has contravened the provisions of Section 181 of the Companies Act, 2013. Hence the auditor should qualify his report accordingly.

15. (a) In the following circumstances, as per the Companies Act, 1956, the retiring auditor cannot be reappointed:

(i) A specific resolution has not been passed to reappoint the retiring auditor.

(ii) The auditor proposed to be reappointed does not possess the qualification prescribed under section 226.

(iii) The proposed auditor suffers from the disqualifications under section 226(3) and 226(4).

(iv) He has given to the company notice in writing of his unwillingness to be reappointed.

(v) A resolution has been passed in AGM appointing somebody else or providing expressly that the retiring auditor shall not be reappointed.

(vi) A written certificate has not been obtained from the proposed auditor to the effect that the appointment or reappointment, if made, will be in accordance within the limits specified under section 224(1B).

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

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

Advantages of Joint Audit

(i) Pooling and sharing of expertise

(ii) Advantage of mutual consultation.

(iii) Lower work load

(iv) Better quality of work performance.

(v) Improved service to the client.

(vi) Displacement of the auditor of the company in a take-over often obviated.

(vii) In respect of multinational companies, the work can be spread using the expertise if the local firms which are in a better position to deal with detailed work and the local laws and regulations.

(viii) Lower staff development costs.

(ix) Lower costs to carry out the work.

(x) A sense of healthy competition towards a better performance.

Disadvantages of Joint Audit:

(i) The fees being shared.

(ii) Psychological problem where firms of different standing are associated in the joint audit.

(iii) General superiority complexes of some auditors.

(iv) Problems of coordination of the work.

(v) Areas of work of common concern being neglected.

(vi) Uncertainty about the liability for the work done.

(vii) Lack of clear definition of responsibility.

16. (a) Sale of Investments without Proper Authorisation: There should be proper authority for sale of investments. Detailed records regarding disposal of investments should be maintained along with proper documentation.

In the instant case, Mr. B had sold the investments without discussing the matter with the other committee members. This matter, therefore, needs to be addressed by the auditor as purchase and sale can only be authorised by the Committee.

The fact that Mr. B believed that the prices would fall and the company would suffer a loss if the investments are not sold is not good enough for Mr. B to act as per his discretion. A profit of ₹ 1 lakh from such sale is also not a sufficient reason to act since one cannot rule out the possibility of earning higher profits. The formation of the Committee by A Ltd, to control sale and purchase of investments is, perhaps, one of the best aspects of internal control system to eliminate the possibility of manipulation, if any, in sale and purchase of investments. The statutory auditor may however, examine whether there have been any other instances involving non-observance of internal control system and procedures. In any case, the Committee must approve the transaction and authorise the same from the view point of the statutory auditor.

(b) Sale and Leaseback of Vehicles: Under a lease agreement, the lessee acquires the right to use an asset for an agreed period of time in consideration for payment of rent to the lessor. The legal ownership of the asset remains with the lessor.

In the instant case, the company had sold vehicles to two leasing companies to meet its liquidity crises and took them back on lease. In the notes to the accounts it had disclosed about instalments payable to different leasing companies, but without disclosing the true nature of the transaction as covered by AS 19, “Leases”.

The transaction entered into by the company is a classic case of sale and leaseback transaction. In case of such transactions, the sale price of assets and lease rentals normally do not represent fair value since the same are negotiated as a package. In case such a transaction is an operating lease and it is clear that the rentals and the sale price are established at fair value, then in effect it is a normal sale transaction and any profit or loss is normally recognised immediately.

If the sale price is below fair value, any profit or loss is recognised immediately, except that, if the loss is compensated by future rentals at below market price, it is deferred and amortized in proportion to the rental payments over the useful life of the asset.

If the sale price is above fair value, the excess over fair value is deferred and amortized over the useful life or the asset.

Therefore, it would be important for the auditor to determine whether the amount of instalments payable is fair having regard to sale price of assets. In case the leaseback is a finance lease, it is not appropriate to regard an excess of sales proceeds over the carrying amount as income.

Such excess is deferred and amortised over the lease term in proportion to the depreciation of the leased asset. Similarly, it is not appropriate to regard a deficiency as loss. Such deficiency is deferred and amortised over the lease term.

Further, disclosure shall have to be made separately of such transaction in terms of AS 5.

The auditor should, therefore, suitably qualify his report since proper disclosures have not been made as per the requirement of accounting standards.

(c) Non-provision of depreciation: 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 machinery has been imported by one entity, it means it was intended to be used for the purpose of business.

Depreciation in respect of this machinery ought to have been provided in the accounts for all the previous years. 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.

Thus, the auditor should ensure compliance with all these requirements and in case of failure he should qualify the report.

17. (a) Basic elements of the Auditor's Report: As per SA 700, "Forming an Opinion and Reporting on Financial Statements", the auditor's report includes the following basic elements, ordinarily, in the following layout:

(i) Title;

(ii) Addressee;

(iii) Introductory Paragraph

(vi) Management's Responsibility for the Financial Statements.

(v) Auditor's Responsibility

(vi) Auditor's Opinion

(vii) Other Reporting Responsibilities

(viii) Signature of the Auditor

(ix) Date of Auditor's Report.

(x) Place of signature

(b) The auditor should express an unqualified opinion when he concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for preparation and presentation of the financial statements.

An unqualified opinion indicates that:

(i) The financial statements have been prepared using the generally accepted accounting principles and being constantly followed.

(ii) The financial statements comply with relevant statutory requirements and regulations.

(iii) All material matters relevant to proper presentation of the financial information, subject to statutory requirement, if applicable, have been adequately disclosed.

18. Verification of application and allotment money received on Shares Issued for Cash shall be carried out as under:

On Application: Verify the amount received along with the applications for shares in the following manner:

(i) Check entries in the Application and Allotment Book (or Sheets) with the original applications;

(ii) Check entries in the Application and the Allotment Book as regards deposits of money, received with the applications, with those in the Cash Book;

(iii) Vouch amounts refunded to the unsuccessful applicants with copies of Letters of Regret;

(iv) Check the totals columns in the Application and Allotment Book and confirm the journal entry debiting Share Application Account and crediting Share Capital Account.

On Allotment

(i) Examine Director's Minutes Book to verify approval of allotments.

(ii) Compare copies of letters of allotment with entries in the Application and Allotment Book.

(iii) Trace entries in the Cash book into the Application and Allotment Book for the verification of amounts collected on allotment.

(iv) Trace the amount collected on application as well as those on allotment from the Application and Allotment Book into the Share Register.

(v) Check whether the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on such application have been received by the company.

(vi) Check that the amount payable on the application on every security is not less than five percent of the nominal amount of security or such other percentage or amount as may be prescribed by the SEBI.

(vii) If the stated minimum amount has not been subscribed and the sum payable on subscription is not received within a period of thirty days from the date of issue of the prospectus or such period as my be specified by the SEBI, check that the amount received above is returned within a period of fifteen days from the closure of the issue and if in case the amount is not repaid within such period, the directors in default shall jointly and severally be liable to repay that amount with interest at the rate of fifteen percent per annum.

(v) Check totals of amounts payable on allotment and verify the journal entry debiting Share Allotment Account and crediting Share Capital Account.

19. (a) Five special points to be looked into while examining the income and collection of funds by an NGO engaged in providing relief work for flood victims are:-

(i) Grant donations and contributions received from various Government, other NGO, industry and public should be checked with reference to the grant letter, bank statements and ensured that they are properly accounted and banked.

(ii) Foreign contribution received should be checked with reference to the correspondence receipt issued, bank statement, conversion into local currency. It should be ensured that all such contributions are as per RBI guidelines and be kept in separate bank account.

(iii) In the case of any fund raising cultural or sports program, verify the internal control system, mode of receipt and the authority accountable. Ensure that all collections are duly receipted and deposited in the bank promptly.

(iv) Check the fee received from members with the register of members.

(v) Check interest and dividend received from investments with investment held.

(b) Advantages of audit of accounts of a partnership firm: Advantages are as follows (any five):

(i) Audited accounts provide a convenient and reliable means of settling accounts between the partners and thereby possibility of dispute among them is mitigated.

(ii) On the retirement/death of a partner, audited accounts constitutes a reliable evidence for computing the amount due to the retiring partner or representative of deceased partner.

(iii) Audited accounts are generally accepted by the Income tax authorities for computing the assessable income.

(iv) Audited accounts are relied upon by banks for advancing loan.

(v) Audited accounts can be helpful in the negotiation for sale or admission of a new partner.

(vi) It is an effective safeguard against any undue advantage being taken by a working partner as against the non working partners.

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

(i) *Audit against Rules & Orders*: The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.

(ii) *Audit of Sanctions*: The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.

(iii) *Audit against Provision of Funds*: It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.

(iv) *Propriety Audit*: It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.

(v) *Performance Audit*: This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

Applicability of Pronouncements/Legislative Amendments/Circulars etc. for November, 2014 – Intermediate (IPC) Examination

Paper 5: Advanced Accounting

Accounting Standards

AS 4 : Contingencies and Events occurring after the Balance Sheet Date

AS 5 : Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

AS 11 : The Effects of Changes in Foreign Exchange Rates (Revised 2003)

AS 12 : Accounting for Government Grants

AS 16 : Borrowing Costs

AS 19 : Leases

AS 20 : Earnings Per Share

AS 26 : Intangible Assets

AS 29 : Provisions, Contingent Liabilities and Contingent Assets.

Non-Applicability of Ind ASs for November, 2014 Examination

The MCA has hosted on its website 35 Indian Accounting Standards (Ind AS) without announcing the applicability date. Students may note that these Ind ASs are not applicable for November, 2014 Examination.

Paper 6: Auditing and Assurance

I. Standards on Auditing (SAs)

S.No	SA	Title of Standard on Auditing
1	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
2	SA 210	Agreeing the Terms of Audit Engagements
3	SA 220	Quality Control for Audit of Financial Statements
4	SA 230	Audit Documentation
5	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements

6	SA 250	Consideration of Laws and Regulations in An Audit of Financial Statements
7	SA 260	Communication with Those Charged with Governance
8	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
9	SA 299	Responsibility of Joint Auditors
10	SA 300	Planning an Audit of Financial Statements
11	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
12	SA 320	Materiality in Planning and Performing an Audit
13	SA 330	The Auditor's Responses to Assessed Risks
14	SA 402	Audit Considerations Relating to an Entity Using a Service Organization
15	SA 450	Evaluation of Misstatements Identified during the Audits
16	SA 500	Audit Evidence
17	SA 501	Audit Evidence - Specific Considerations for Selected Items
18	SA 505	External Confirmations
19	SA 510	Initial Audit Engagements-Opening Balances
20	SA 520	Analytical Procedures
21	SA 530	Audit Sampling
22	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
23	SA 550	Related Parties
24	SA 560	Subsequent Events
25	SA 570	Going Concern
26	SA 580	Written Representations
27	SA 600	Using the Work of Another Auditor
28	SA 610	Using the Work of Internal Auditors
29	SA 620	Using the Work of an Auditor's Expert
30	SA 700	Forming an Opinion and Reporting on Financial Statements

31	SA 705	Modifications to the Opinion in the Independent Auditor's Report
32	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
33	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements
34	SA 720	The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

II. Statements

1. Statement on Reporting under Section 227(1A) of the Companies Act, 1956.
2. Statement on the Companies (Auditor's Report) Order, 2003.

III. Guidance Notes

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

Notes