

**MOCK TEST PAPER- 1**  
**INTERMEDIATE (NEW) GROUP – II**  
**PAPER – 6: AUDITING AND ASSURANCE**

Time Allowed – 3 Hours

Maximum Marks – 100

**Division A- Multiple Choice Questions**

**Case Scenario 1 carries 10 Marks**

**Case Scenario 2 carries 10 Marks**

**Total 30 Marks**

**General MCQs carry 2 Marks each**

**Case Scenario 1**

A Partnership Firm of Chartered Accountants by the name of HS and Associates was appointed to audit books of accounts of WT Limited for financial year 2019-20. HS and Associates consisted of two partners CA H and CA S.

While conducting audit of WT Limited for financial year 2019-20, CA H, one of the partners of HS and Associates used different audit procedures in order to obtain audit evidence.

The different audit procedures used by CA H were as follows:

- (1) As WT Limited was engaged in manufacturing business of wooden doors, CA H and his team members carefully watched the whole process of counting of finished wooden doors by employees of WT Limited. The counting of finished wooden doors was necessary for the purpose of verification of stock of finished wooden doors.
- (2) In WT Limited the stock of finished wooden doors was valued manually by multiplying number of finished wooden doors with value per finished wooden door. A team member of CA H again did the calculation in order to verify the accuracy regarding valuation of stock of wooden finished doors.
- (3) CA H with the help of his team members obtained information from people (who were experienced in manufacturing business of wooden doors) about the purchase price of raw materials required in manufacturing business of wooden doors and also obtained some non-financial information.
- (4) CA H and his team members while conducting the audit of WT Limited for financial year 2019-20 in detail checked and evaluated the books of accounts and relevant documents of W Limited.
- (5) CA H asked for written confirmations regarding account balances from Debtors and Creditors of WT Limited.

Keeping the basic concepts about various audit procedures in mind, answer the following multiple-choice questions:

1. CA H and his team members carefully watched the whole process of counting of finished wooden doors by employees of WT Limited. This is an example of which audit procedure:
  - (a) External Confirmation.
  - (b) Observation.
  - (c) Inquiry.
  - (d) Inspection.

2. In order to verify the accuracy regarding valuation of stock of wooden finished doors, a team member of CA H again did the calculation. This is an example of which audit procedure:
  - (a) Analytical Procedures.
  - (b) Inquiry.
  - (c) Inspection.
  - (d) Recalculation.
3. CA H with the help of his team members obtained information (both financial and non-financial information) from experienced people in manufacturing business of wooden doors. These experienced people provided the required information. This whole method of obtaining information is an example of which audit procedure:
  - (a) Inspection
  - (b) Reperformance.
  - (c) Inquiry.
  - (d) Investigation.
4. CA H and his team members in detail checked and evaluated the books of accounts and relevant documents of WT Limited. This is an example of which audit procedure:
  - (a) Inspection.
  - (b) Reperformance.
  - (c) Recalculation.
  - (d) Investigation
5. Asking for written confirmations regarding account balances from Debtors and Creditors of WT Limited by CA H is an example of which audit procedure:
  - (a) Inquiry
  - (b) Inspection
  - (c) Investigation.
  - (d) External Confirmation.

**(5 x 2 = 10 Marks)**

### **Case Scenario 2**

RM & Associates have been appointed as Auditors of Techblocks Consulting Ltd. for the year 2020-21. CA R and CA M were the Engagement partners.

#### Para 1

The Firm has freshly appointed 2 Article Clerks who had no practical knowledge in the area of Auditing. They had to work to tight hard-headed factual issues and were baffling to understand the various terms and their objectives in the field of Auditing.

#### Para 2

To make sure that the Article Clerk do not misplace or mis-handle the Working Papers, CA M also described the relevance of Audit File and clarified that working papers are the property of Auditor. Such Audit file should be preserved for a period of seven years.

#### Para 3

CA R while scrutinizing Books of Accounts suspected some fictitious sales as a result of which he anticipated inflated Debtors. Management was reluctant to give the details. As CA R could not gather more evidence from the Management, he sought to obtain details from the third party.

#### Para 4

On further perusal of Opening Balances, it is essential to perceive that Accounting Policies have been consistently applied in the current period's financial statements and whether any changes have been properly accounted for and disclosed. CA M assigned this duty to his article clerk. The Article clerk explained to CA M about how he had observed that Accounting policies were not consistently applied in relation to opening balances in accordance with the financial reporting framework or a change is not properly accounted or not adequately disclosed.

#### Para 5

Subsequently, the Auditors gathered from the Management that there was a fire in the Factory premises after the Balance Sheet date, as a result of which the company suffered loss of Inventories. It did not provide any conditions on the Balance Sheet date. SA 560 deals with such type of transactions.

1. The Auditor explained his Audit team the purpose of Audit Documentation. Which of the following is incorrect with respect to the purpose of Audit Documentation?
  - (a) It enables the conduct of quality control reviews and inspections in accordance with SQC-1.
  - (b) It helps in preparation of Financial Statements.
  - (c) It retains a record of matters of continuing significance to future audits.
  - (d) It enables the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.
2. An auditor strictly ensured that the audit team should document / assemble all the working papers in Audit file. The completion of assembling the Audit File is an administrative process and should be done in :
  - (a) It should be within 30 days from the date of Audit Report.
  - (b) It should be within 60 days from the completion of Audit.
  - (c) It should not be more than 60 days from the date of Audit Report.
  - (d) It should be before 90 days from the completion of Audit.
3. With reference to para 3 of Case scenario, this is a case of obtaining External Confirmation by the Auditor. Which of the following is inappropriate with regard to External Confirmation?
  - (a) External Confirmations are restricted to Account balances only.
  - (b) It is also used in a case to obtain Audit evidence about the absence of certain conditions say, Side Agreement.
  - (c) It can be also effective in obtaining Audit evidence about verification of Inventories held by third parties at bonded warehouses for processing or on consignment.
  - (d) External Confirmation is also functional in case of Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the Balance Sheet date.
4. With reference to para 4, in such a situation CA M shall express a :
  - (a) A Disclaimer Opinion
  - (b) A qualified opinion
  - (c) A qualified opinion or an adverse opinion in accordance with SA 705
  - (d) An unmodified opinion

5. In respect to subject matter mentioned in Para 5, what procedures should Auditor perform to identify such events?

Statement 1: Obtain an understanding of any procedures management has established as well as Inquiry with Management and those charged with governance procedures for identification of such subsequent events.

Statement 2: Inspection of Minutes 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 the matters discussed at any such meetings for which minutes are not yet available.

Statement 3: The Auditor should not read the entity's latest subsequent interim financial statements, if any.

- (a) Only Statement 1 is correct
- (b) Only Statement 2 is correct
- (c) Both Statements 1 and 2 are correct
- (d) Only Statement 3 is correct

**(5 x 2 = 10 Marks)**

### **General MCQs**

1. Sec. 52 of the Companies Act states that Security Premium Account can be applied by the Company for one of the purpose mentioned below. Which of the following is a CORRECT option?
  - (a) To adjust loss on revaluation of Assets
  - (b) To pay dividend to equity shareholders
  - (c) Providing for the premium payable on redemption of Preference shares
  - (d) To use it as working capital for its business.
2. CA R illustrated to his team that the utility of the Audit Programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under recurrent assessment. Which attribute of the Audit Programme is highlighted here?
  - (a) Static Review
  - (b) Mechanical Review
  - (c) Periodic Review
  - (d) Obsolete Review
3. The Firm R K & Associates has an extensive understanding of Code of Ethics that underlies the fundamental principles relevant to the Auditor when conducting an Audit of Financial Statements and provides a conceptual framework for applying these principles. Which of the following does not form part of the fundamental principle?
  - (a) Integrity
  - (b) Professional Competence and due care
  - (c) Professional Skepticism
  - (d) Professional behaviour
4. Which of the following is not an example of an event or condition that may cast significant doubt on entity's ability to continue as a going concern:
  - (a) Loss of key management without replacement
  - (b) Adverse key financial ratios
  - (c) Inability to pay creditors on due date

- (d) Current year profit turns to loss after providing depreciation
5. M/s PQR & Associates is appointed as the new auditors of M/s Prince Ltd. On conducting the audit, the firm found that the accountant has entered fake invoices of credit purchases in the books of a accounts aggregated of ₹ 75 Lakhs and cleared all the payments to the fake creditor.
- The auditor M/s PQR & Associates should report such fraud to :
- (a) Central Government  
 (b) Reserve Bank of India  
 (c) Board of Directors/Audit Committee  
 (d) Comptroller & Auditor General
- (5 x 2=10 Marks)**

### Division B- Descriptive Questions

*Question No. 1 is compulsory.*

*Attempt any **four** questions from the Rest.*

**Total 70 Marks**

1. Examine with reasons (in short) whether the following statements are correct or incorrect : (Attempt any 7 out of 8)
- (i) The auditor is expected to, and can, reduce audit risk to zero and can therefore obtain absolute assurance.
- (ii) The concept of materiality is an important and relevant consideration for the auditor in financial statement.
- (iii) Audit evidence obtained from external confirmation is always reliable.
- (iv) CA K has resigned as an auditor after 2 months of his appointment in NML Ltd. He needs to file ADT-4 with the Registrar within 60 days from the date of resignation.
- (v) Satisfactory Control environment is an absolute deterrent to fraud.
- (vi) K Ltd., a non-government company, was incorporated on 01-10-2019. Mr. B, Managing Director of K Ltd., himself appointed the first auditor of the company on 31-12-2019.
- (vii) All Non-Governmental Organisations (NGOs) registered under the Companies Act, 2013 are allowed to maintain accounts either on accrual basis or cash basis.
- (viii) When auditing in an automated environment, inquiry is often the most efficient and effective audit testing method.
- (7 x 2 = 14 Marks)**
2. Discuss the following:
- (a) The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain **(4 Marks)**
- (b) Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. Explain stating the qualities an auditor should possess. **(4 Marks)**
- (c) "In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement" Explain those considerations in detail. **(3 Marks)**
- (d) In case of a Bank, explain the meaning of Funded loans. Also give examples. **(3 Marks)**

3. (a) Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered. Further, it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Explain giving examples. **(4 Marks)**
- (b) List any five points that an auditor should consider to obtain an understanding of the Company's automated environment. **(4 Marks)**
- (c) Provisions regarding appointment of Auditors -
- (i) First auditor of a Government company and a Non-Government company.
- (ii) Subsequent auditor of a Government company and a Non- Government company. **(6 Marks)**
4. (a) While conducting audit of Vee Ltd, CA Aman, auditor of the company, found that some goods are lying with third party for a long period. Advise Aman how will he verify them. **(4 Marks)**
- (b) State the requirements relating to audit sampling, sample design, sample size and selection of items for testing. **(4 Marks)**
- (c) The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control. **(3 Marks)**
- (d) As per Section 138 of the Companies Act, 2013 only listed companies are required to appoint an internal auditor. **(3 Marks)**
5. (a) Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances. **(4 Marks)**
- (b) Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence. Explain stating the objective behind committing such fraud. **(4 Marks)**
- (c) "The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long term loans and advances." Advise the auditor regarding reporting requirements under CARO, 2016. **(3 Marks)**
- (d) "An auditor is required to make specific evaluations while forming an opinion in an audit report." State those specific evaluations. **(3 Marks)**
6. (a) "There is no difference in provisioning of NPA as regards to categories of NPA, whether the debt is secured or unsecured." Critically evaluate the statement on the basis of provisioning norms of NPA of nationalised bank stating clearly the provision percent required. **(4 Marks)**
- (b) You have been appointed auditor of Dr. Prem Ratan Hospital. Discuss any eight important points that would attract your attention while audit. **(4 Marks)**

**OR**

- (c) "While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel but for other expenses, an auditor generally prefers to verify other attributes." Mention those attributes. **(4 Marks)**
- (d) As an auditor of listed company, what are the matters that the auditor should keep in mind while determining "Key Audit Matters". **(3 Marks)**
- (e) "Public moneys should not be utilised for the benefit of a particular person or section of the community". List out the exceptions to this rule while audit against propriety. **(3 Marks)**

**MOCK TEST PAPER 1**  
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**SUGGESTED ANSWERS / HINTS**  
**Division A-Multiple Choice Questions**

**Case Scenario 1**

1. (b)
2. (d)
3. (c)
4. (a)
5. (d)

**Case Scenario 2**

1. (b)
2. (c)
3. (a)
4. (c)
5. (c)

**General MCQs**

1. (c)
2. (c)
3. (c)
4. (d)
5. (c)

**Division B -Descriptive Answers**

1. (i) **Incorrect:** The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.
- (ii) **Correct:** 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 and ensure that a material item is disclosed separately and distinctly.
- (iii) **Incorrect:** 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. 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.

- (iv) **Incorrect:** As per section 140(2) of the Companies Act, 2013, the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) with the company and the Registrar.
  - (v) **Incorrect:** The existence of a Satisfactory Control environment can be a positive factor when an auditor assesses the risk of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory Control environment is not an absolute deterrent to fraud.
  - (vi) **Incorrect:** Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. In view of the above, the appointment of first auditor made by the managing director is in violation of the provisions of the Companies Act, 2013
  - (vii) **Incorrect:** NGOs registered under the Companies Act, 2013 must maintain their books of account under the accrual basis as required by the provisions of section 128 of the said Act. If the accounts are not maintained on accrual basis, it would amount to non-compliance of the provision of the Companies Act, 2013. The NGOs which are not registered under the Companies Act, 2013 are allowed to maintain accounts either on an accrual basis or cash basis.
  - (viii) **Incorrect:** There are basically four types of audit tests that should be used in an automated environment. They are inquiry, observation, inspection and re-performance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Applying inquiry in combination with inspection gives the most effective and efficient audit evidence.
2. (a) The person conducting the audit should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:
- (i) the accounts have been drawn up with reference to entries in the books of account;
  - (ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;
  - (iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
  - (iv) the information conveyed by the statements is clear and unambiguous;
  - (v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
  - (vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.
- (b) It is not enough to realise what an auditor should be. He is concerned with the reporting on financial matters of business and other institutions. Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent. The qualities required, according to Dicksee, are tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability. In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor. In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence. In fact, Code of ethics mentions integrity, objectivity and independence as one of the fundamental principles of professional ethics.
- He must have a thorough knowledge of the general principles of law which govern matters with which he is likely to be in intimate contact. The Companies Act need special mention but mercantile law, specially the law relating to contracts, is no less important. Needless to say, where

undertakings are governed by a special statute, its knowledge will be imperative; in addition, a sound knowledge of the law and practice of taxation is unavoidable.

He must pursue an intensive programme of theoretical education in subjects like financial and management accounting, general management, business and corporate laws, computers and information systems, taxation, economics, etc. Both practical training and theoretical education are equally necessary for the development of professional competence of an auditor for undertaking any kind of audit assignment.

The auditor should be equipped not only with a sufficient knowledge of the way in which business generally is conducted but also with an understanding of the special features peculiar to a particular business whose accounts are under audit. The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.

He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is the *sine qua non* of the practice of auditing. He must know thoroughly all accounting principles and techniques.

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

- (c) In establishing the overall audit strategy, the auditor shall:
- (a) Identify the characteristics of the engagement that define its scope;
  - (b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
  - (c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
  - (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
  - (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.
- (d) **Funded** loans are those loans where there is an actual transfer of funds from the bank to the borrower.

**Advances comprise of funded amounts by way of:**

- Term loans :-
  - Cash credits, Overdrafts, Demand Loans
  - Bills Discounted and Purchased
  - Participation on Risk Sharing basis
  - Interest-bearing Staff Loans
3. (a) Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:
- ◆ The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.

- ◆ The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
  - ◆ An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.
  - ◆ In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
    - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
    - Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315.
- (b) **Understanding of the Company's Automated Environment:** Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment
- Information systems being used (one or more application systems and what they are)
  - their purpose (financial and non-financial)
  - Location of IT systems - local vs global
  - Architecture (desktop based, client-server, web application, cloud based)
  - Version (functions and risks could vary in different versions of same application)
  - Interfaces within systems (in case multiple systems exist)
  - In-house vs Packaged
  - Outsourced activities (IT maintenance and support)
  - Key persons (CIO, CISO, Administrators)
- (c) (i) **Appointment of First Auditor of a Government Company:** Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.
- In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.
- Appointment of First Auditor of a Non-Government Company:** As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company,

shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

- (ii) **Appointment of Subsequent Auditor of a Government Company:** As per Section 139(5) of the Companies Act, 2013, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

**Appointment of Subsequent Auditor of a Non-Government Company:** As per section 139(1) of the Companies Act, 2013, every company shall, 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 and thereafter till the conclusion of every sixth meeting.

4. (a) **Goods Lying with Third Party:** The auditor should check that the materiality of the item under this caption included in inventories.
- (i) He should obtain confirmation of the amount of goods lying with them. The confirmation may be directly obtained by auditor or be produced by client depending upon the situation.
  - (ii) He should inquire into the necessity of sub contractor retaining the inventory. He should ensure the process that they do are related to the business requirement and there is no ground for suspicion on this score.
  - (iii) The goods lying with them for the very long period would merit auditors' special attention for making provision.
  - (iv) The records, voucher/slips for the regulating the movement of inventory into and out of entity for sub-contracting work be reviewed by vouching for few transaction for ensuring existence and working of internal control system for them.
  - (v) The excise gate pass, entry in such records, information in returns, be also cross-verified.
  - (vi) The valuation of inventories should be correctly made for including material cost on appropriate inventory valuation formulae and also for inclusion of proportionate processing charges for the work in process with the contractors.
  - (vii) The provision should be created for work done, billed for processing and also for incidence of any applicable levy like service tax payable.
  - (viii) Evaluate condition of goods and see whether adequate provision has been made.
  - (ix) Check whether subsequently the goods lying with third party were sold or received back after the expiry of stipulated time period.
  - (x) Ensure that the goods have been included in the closing inventory though lying with third party.

- (b) **Audit Sampling:** As per SA 530 on “Audit Sampling”, the meaning of the term Audit Sampling is – the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The requirements relating to sample design, sample size and selection of items for testing are explained below-

**Sample design** - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.

**Sample Size-** The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

**Selection of Items for Testing-** The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

- (c) **Division of Internal Control into Components:** The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity’s internal control may affect the audit:

- (i) The control environment;
- (ii) The entity’s risk assessment process;
- (iii) Monitoring of controls.
- (iv) Control activities; and
- (v) The information system, including the related business processes, relevant to financial reporting, and communication;

- (d) **Applicability of Provisions of Internal Audit:** As per section 138 of the Companies Act, 2013 the following class of companies (prescribed in rule 13 of Companies(Accounts) Rules,2014) shall be required to appoint an internal auditor (which may be either an individual or a partnership firm or a body corporate), namely-

- (1) every listed company;
- (2) every unlisted public company having-
  - (i) paid up share capital of fifty crore rupees or more during the preceding financial year; or
  - (ii) turnover of two hundred crore rupees or more during the preceding financial year; or
  - (iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
  - (iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
- (3) every private company having-
  - (i) turnover of two hundred crore rupees or more during the preceding financial year; or
  - (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In view of above, it would not be correct to state that only Listed Companies are required to appoint an internal auditor.

5. (a) **Analytical Review Procedures:** The following analytical review procedures may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances-

- (i) comparison of closing balances of trade receivables, loans and advances with the corresponding figures for the previous year;
  - (ii) comparison of the relationship between current year trade receivable balances and the current year sales with the corresponding budgeted figures, if available;
  - (iii) comparison of actual closing balances of trade receivables, loans and advances with the corresponding budgeted figures, if available;
  - (iv) comparison of current year's ageing schedule with the corresponding figures for the previous year;
  - (v) comparison of significant ratios relating to trade receivables, loans and advances with similar ratios for other firms in the same industry, if available;
  - (vi) comparison of significant ratios relating to trade receivables, loans and advances with the industry norms, if available.
- (b) Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way. This type of fraud is generally committed:
- (a) to avoid incidence of income-tax or other taxes;
  - (b) for declaring a dividend when there are insufficient profits;
  - (c) to withhold declaration of dividend even when there is adequate profit (this is often done to manipulate the value of shares in stock market to make it possible for selected persons to acquire shares at a lower cost); and
  - (d) for receiving higher remuneration where managerial remuneration is payable by reference to profits.
- (c) **The auditor is required to report as per clause xiv of paragraph 3 of CARO 2016**, whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

In view of the above clause, the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose rather the company has utilised these funds for repayment of long term loans and advance.

- (d) **Specific Evaluations by the auditor:** The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

In particular, the auditor shall evaluate whether :

- (i) The financial statements adequately disclose the significant accounting policies selected and applied;
- (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (iii) The accounting estimates made by management are reasonable;
- (iv) The information presented in the financial statements is relevant, reliable, comparable, and

understandable;

- (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

6. (a) **Classification as NPA** should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub-standard assets, Doubtful assets and loss assets which are given below:

Categories of Non-Performing Assets:	Provision required						
<ul style="list-style-type: none"> <li>◆ <b>Substandard Assets:</b> Would be one, which has remained NPA for a period less than or equal to 12 months.</li> </ul>	15%						
<ul style="list-style-type: none"> <li>◆ <b>Doubtful Assets:</b> Would be one, which has remained in the substandard category for a period of 12 months.</li> </ul>	Secured+ Unsecured						
<ul style="list-style-type: none"> <li>◆ <b>Sub-categories:</b> <ul style="list-style-type: none"> <li>Doubtful up to 1 Year (D1)</li> <li>Doubtful 1 to 3 Years (D2)</li> <li>Doubtful more than 3 Years (D3)</li> </ul> </li> </ul>	<table style="width: 100%; border: none;"> <tr> <td style="width: 50%;">25%</td> <td style="width: 50%;">+ 100%</td> </tr> <tr> <td>40%</td> <td>+ 100%</td> </tr> <tr> <td>100%</td> <td>+ 100%</td> </tr> </table>	25%	+ 100%	40%	+ 100%	100%	+ 100%
25%	+ 100%						
40%	+ 100%						
100%	+ 100%						
<ul style="list-style-type: none"> <li>◆ <b>Loss Assets:</b> Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.</li> </ul>	100%						

(b) **AUDIT OF HOSPITAL**

The important points involved in such an audit are stated below-

- (i) **Register of patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For eg. copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills etc.
- (iii) **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.
- (iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown

by the Subscription Register and the amount collected and that still outstanding).

- (vi) **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.
  - (vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
  - (viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
  - (ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
  - (x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
  - (xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
  - (xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.
  - (xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.
- (c) **While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:**
- (i) Whether the expenditure pertained to current period under audit;
  - (ii) Whether the expenditure qualified as a revenue and not capital expenditure;
  - (iii) Whether the expenditure had a valid supporting like travel tickets, insurance policy, third party invoice etc.;
  - (iv) Whether the expenditure has been classified under the correct expense head;
  - (v) Whether the expenditure was authorised as per the delegation of authority matrix;
  - (vi) Whether the expenditure was in relation to the entity's business and not a personal expenditure
- (d) **Determining Key Audit Matters:** As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:
- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
  - (ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
  - (iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

- (e) **Exceptions to the rule – Audit Against Propriety:** Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
- (i) the amount of expenditure involved is insignificant; or
  - (ii) a claim for the amount could be enforced in a Court of law; or
  - (iii) the expenditure is in pursuance of a recognised policy or custom; and
  - (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.