

MOCK TEST PAPER- 2
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

Mars Ltd. is a public limited Company incorporated during the previous financial year 2019-20. R S Shah & Associates have been appointed as the Auditors of the Company.

Para 1

Its Authorized Capital was Rs. 75 Lacs. Subsequently it increased its Share Capital. They issued Shares at a premium of Rs.25/- per share. The Company has transferred the amount received as premium to the Securities Premium Account.

Para 2

CA R recommended his Engagement Team to prepare an Audit Strategy as well as Audit plan for efficient conduct of audit. He advised to the team that they should include a series of verification procedures to be applied to Financial Statements of the Company for accomplishing the Audit objectives. CA R illustrated to his team the relationship between Audit strategy as well as Audit plan.

Para 3

Encompassed by a huge clientele, one of the Auditee firm was a LLP. It was in the name of Mangaldeep Geotech LLP. They conducted the business in a very efficient way but had allotted only the Audit and the Income Tax work to CA R S Shah & Associates. The Partners of the LLP were capable enough but however inadvertently bypassed the ROC Compliances. They had no knowledge about the Compliances and its related penalties. Thus they approached CA R S Shah and Associates for their guidance. They were completely clueless as to filing of Annual Return with ROC.

Para 4

R S Shah and Associates have been appointed as Auditors of a large Enterprise namely Search Results Ltd. Considering the overhaul required in the Organization's Risk Management, Directors of the listed companies braced the subject of Internal Financial Control with much seriousness and rigor. The dawn of the Financial Year lays down the daunting task of establishing and implementing Internal Financial Control in an Enterprise.

Para 5

The Auditors are performing their Audit work in the Company Search Results Ltd by using CAAT's. The Company is completely automated and all the processes, operations are carried out using the Computer systems. Testing is performed in an automated environment to increase the efficiency and allow for more robust tools to be built. There are four types of testing methods in an Automated environment. They are Inquiry, Observation, Inspection and Re-performance.

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 an INCORRECT option?

- (a) To write off preliminary expenses of the Company
 - (b) To pay dividend to equity shareholders
 - (c) To provide premium on redemption of Preference share capital
 - (d) To purchase its own shares or other securities under Sec 68(Buyback)
2. In reference to para 2, which of the following Statement is inappropriate?
- (a) Once the overall audit strategy is established, an audit plan can be developed to address the various matters identified in the overall audit strategy.
 - (b) The establishment of overall audit strategy as well as detailed audit plan is a discrete and sequential process.
 - (c) Audit Strategy and Audit plan are inter-related as changes in one may result in consequential changes to the other.
 - (d) The Audit plan is more detailed than the Audit Strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.
3. In reference to para 3, which form from the following should be filed by the Partners to avoid penalty consequences?
- (a) Form 11 within 90 day of end of closer of financial year and Form 8 within a period of 60 days from the end of six months of the financial year.
 - (b) Form 11 within 60 days of end of closer of financial year and Form 8 within a period of 30 days from the end of six months of the financial year.
 - (c) Form 11 within 30 days of end of closer of financial year and Form 8 within a period of 60 days from the end of three months of the financial year.
 - (d) Form 11 within 60 day of end of closer of financial year and Form 8 within a period of 90 days from the end of three months of the financial year.
4. With reference to para 4, which of the following point ensures implementation of policies and procedures with regard to Internal Financial Control by the Companies?
- (a) Reliability of Financial Reporting
 - (b) Effectiveness and efficiency of operations
 - (c) Compliance with applicable laws and regulations
 - (d) All of the above.
5. Which of the following statement is inappropriate with regard to testing methods as mentioned in Para 5 above?
- (a) Inquiry in combination with Inspection gives the most effective and efficient audit evidence.
 - (b) Re-performance is the most effective as an audit test and gives the best audit evidence.
 - (c) Inquiry should always be used in combination with any other testing method.
 - (d) which audit test to use and in what combination does not require professional judgment.

(5 x 2 = 10 Marks)

Case Scenario 2

A Partnership Firm of Chartered Accountants by the name of S K and Associates were appointed as the Auditors of the Company named Big Box Ltd.

Para 1

Big Box Ltd is a Public Listed Company. The CA Firm comprised of 2 partners namely CA S and CA K. Subsequently, a close relative of CA K, acquired security having face value Rs.495000/- of Big Box Ltd. As per the provisions of Section 141 of the Companies Act 2013, an Auditor will be disqualified from appointment, if the Auditor himself or his relative acquires the security exceeding the prescribed limit in the Company.

Para 2

Further, the Auditors, S K and Associates also had to bank on the policies and procedures adopted by the Company for ensuring the efficient conduct of its business. They have to state about the adequacy of Internal Financial Controls in the Company. The Company had a turnover of Rs. 60 Crores as per the latest Audited Balance Sheet and its Borrowings during the year were Rs. 20 Crores from Banks.

Para 3

The CFO of the Company, Mrs. Darshana felt dubious in the Accounts department of the Company. She entreated the Auditors to perform a thorough investigation of the Accounts department. Mrs. Darshana was also anticipating a fraud in this situation. Both the Auditor as well as the CFO of the Company analyzed the various risk factors. The Auditors observed that the Head Accountant of the Department has inflated the Sales amount to finish his targets. There was collusion between the Head Accountant & Employees of the Company. Employees were presented incentives on accomplishing their targets. This resulted in a fraud by the Head Accountant of amount aggregating to Rs.75 Lacs.

Para 4

Mr. X, an acquaintance of CA S, wanted to form an LLP with his distant relatives. He wanted to possess in-depth knowledge about LLP. CA S explained him that LLP is a separate legal structure and is liable to full extent of its assets but the partners are liable to the extent of their agreed contribution in LLP. Mr. X additionally wanted to know the criteria for the accounts of LLP to be audited. CA S enlightened him that the accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.

Para 5

Big Box Ltd. is expanding its business. Consequently it requires many Computers. Purchasing computers may involve paying a huge upfront cost. Cash flow may get disrupted. Hence the Company came up with an idea of getting the Computers on lease. It will allow the businesses to have access to the latest technology without harming their cash flow.

The Auditors explained to the Directors that leasing Computers shall come under the purview of Operating Lease.

1. With reference to para 1, S K and Associates can take corrective actions within _____ days. The relative may hold security or interest in the company of face value not exceeding _____
 - (a) 45 days, Face Value Rs.100000/-
 - (b) 60 days, Market Value Rs.500000/-
 - (c) 30 days, Face Value Rs. 500000/-
 - (d) 60 days, Face Value Rs.100000/-

2. The Auditors of S K and Associates were doubtful concerning the applicability of Internal Financial Controls in the Company Big Box Ltd. With reference to details provided in Para 2 above, please guide

them in this regard.

- (a) It will be applicable as Turnover exceeds the threshold limit of Rs.50 Crores.
 - (b) It is not applicable as the Borrowings are less than 25 Crores during the financial year.
 - (c) It will be applicable as the Company is a Public Listed Company.
 - (d) Reporting on Internal Financial Control is not under the scope of Auditors reporting. Hence, Not Applicable.
3. With reference to para 3, wherein a fraud was observed by the Auditor, what should be the course of action of the Auditor?
- (a) The Auditor should report the fraud details to Central Government.
 - (b) The Auditor shall report the fraud to the audit Committee or to the Board within the prescribed time.
 - (c) The Auditor shall disclose it in the Audit Report and report the fraud details to RBI too.
 - (d) Both a & c above.
4. With regard to information provided in Para 4, which of the following is a CORRECT option?
- (a) Any LLP whose turnover does not exceed, in any financial year, Rs.40 Lacs or whose contribution does not exceed Rs.25 Lacs is not required to get its accounts audited.
 - (b) Any LLP whose turnover does not exceed, in any financial year, Rs.50 Lacs or whose contribution does not exceed Rs.20 Lacs is not required to get its accounts audited.
 - (c) Any LLP whose turnover exceeds Rs.25 Lacs in any financial year or whose contribution exceeds Rs.10 Lacs in any financial year is required to get its accounts audited.
 - (d) Any LLP whose turnover does not exceed, in any financial year, Rs.40 Lacs and whose contribution does not exceed Rs.25 Lacs is not required to get its accounts audited.
5. In reference to para 5, which among the following is an INCORRECT trait about the Operating Lease?
- (a) The Lessee does not have the option to buy the asset during the lease period.
 - (b) The Lessee cannot claim Depreciation on the leased asset.
 - (c) The Lessee generally bears the Insurance, Maintenance and Taxes.
 - (d) The Lease term generally extends to less than 75% of the projected useful life of the leased asset.

(5 x 2 = 10 Marks)

General MCQs

1. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
- (a) Withdraw from the audit engagement where possible under applicable law or regulation;
 - (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.
 - (c) Withdraw from the audit engagement where possible under applicable law or regulation and determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.
 - (d) Withdraw from the audit engagement where possible under applicable law or regulation or determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

2. Audit documentation provides:
- (a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; or evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.
 - (b) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.
 - (c) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor
 - (d) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.
3. Audit evidence includes
- (a) information contained in the accounting records underlying the financial statements
 - (b) both information contained in the accounting records underlying the financial statements and other information.
 - (c) other information.
 - (d) information contained in the accounting records underlying the financial statements information.
4. Risk of material misstatement may be defined as the risk
- (a) that the financial statements are materially misstated after audit.
 - (b) that the financial statements are materially misstated during audit.
 - (c) that the financial statements are materially misstated prior to audit.
 - (d) All of the above
5. Statement I : A capital reserve cannot be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.
- Statement II : The amount of securities premium or capital redemption reserve account can be utilised only for the purposes specified in Sections 52 and 55 of the Companies Act, 2013, respectively.
- (a) only Statement I is correct
 - (b) only Statement II is correct
 - (c) both the statements are correct
 - (d) both the statements are incorrect.
- (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 preparation of financial statements involves judgment by management.
 - (ii) Evolving one audit programme applicable to all business under all circumstances is not practicable
 - (iii) Inquiry alone ordinarily does not provide sufficient audit evidence.
 - (iv) The SAs do not ordinarily refer to inherent risk and control risk separately.
 - (v) Intentional errors are most difficult to detect and auditors generally devote greater attention to this type
 - (vi) All automated environments are not complex.
 - (vii) A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as meaningful data.
 - (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 Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 provides certain powers to the C & AG in connection with performance of his duties. Discuss. **(4 Marks)**
 - (b) Fraud in the form of misappropriation of goods is still more difficult to detect. Explain. **(4 Marks)**
 - (c) Describe how risks in IT systems, if not mitigated, could have an impact on audit. **(3 Marks)**
 - (d) CA X is not sure about the kind of Sampling method to be used for audit of a company. Advise him about the choice of methods (name of methods only) of Sampling to be used in various circumstances. Also explain briefly the advantages of the Sampling to be used by him in auditing. **(3 Marks)**
3. (a) As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client. Explain stating clearly the information that would assist the auditor in accepting and continuing of relationship with the client. **(4 Marks)**
- (b) In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement. **(4 Marks)**
- (c) The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation. **(3 Marks)**
- (d) Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit. **(3 Marks)**
4. (a) Explain the meaning of internal financial controls as per the Companies Act, 2013. Also explain its objectives. **(4 Marks)**
- (b) The auditor may choose to analyse the monthly trend for Power & Fuel expense. Explain how this analysis will be performed by the auditor **(4 Marks)**
- (c) Write the audit Procedure for verification of existence of Trade Receivables. **(6 Marks)**

5. (a) Management of Z Ltd. wants to include all the cost incurred by the Company in valuing the cost of its inventories. The Accountant is, however, of the view that certain costs should be excluded from the cost of inventories and should be recognised as expenses for the period in which they are incurred. What are such costs that should be excluded while determining the cost of inventories? **(4 Marks)**
- (b) Enumerate the circumstances under which the retiring auditor can be re-appointed. **(4 Marks)**
- (c) State the matters to be included in auditor's report as per CARO, 2016 regarding:
- (i) Default in repayment of loan or borrowing to a financial institution, bank etc. **(3 Marks)**
 - (ii) Fraud by the company or on the company by its officers or employees. **(3 Marks)**
- (d) Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. **(3 Marks)**
6. (a) Explain "Advances under Consortium" in the context of Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances. **(4 Marks)**
- (b) What is the function of audit while examining various rules, regulations and orders with regard Audit against Rules & Orders by C&AG? **(4 Marks)**

OR

- (c) (i) List out the types of Revenue Grants received by local bodies from the State. **(2 Marks)**
- (ii) PQR Ltd., a government company, constructed a building in conformity with rules and regulations for installing a telephone exchange but not used for the same purpose resulting in the infructuous expenditure.
- Considering the above case, explain the type of expenditure audit to be performed to curb the situation. **(2 Marks)**
- (d) In the course of audit of SMP Limited for the financial year ended 31st March, 2020 you have observed as an auditor that the company has provided a sum of ` 20 Lakhs in the books of account as Gratuity payable to employees based on certificate obtained from an actuary. Give your comments with reference to *the Standard on Auditing*. **(3 Marks)**
- (e) Explain the objectives of the auditor regarding written representations. **(3 Marks)**

MOCK TEST PAPER 2
INTERMEDIATE (NEW): GROUP – II
PAPER – 6: AUDITING AND ASSURANCE
SUGGESTED ANSWERS / HINTS
Division A-Multiple Choice Questions

Case Scenario 1

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

Case Scenario 2

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

General MCQs

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

Division B -Descriptive Answers

1. (i) **Correct:** 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.
- (ii) **Correct:** Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable

- (iii) **Correct:** Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.
 - (iv) **Correct:** The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
 - (v) **Correct:** Intentional errors are most difficult to detect and auditors generally devote greater attention to this type because out of long and sometimes unfortunate experience, auditors have developed a point of view that, if they direct their procedures of discovering the more difficult intentional errors, they are reasonably certain to locate the more simple and far more common unintentional errors on the way.
 - (vi) **Correct:** The complexity of an automated environment depends on various factors including the nature of business, level of automation, volume of transactions, use of ERP and so on. There could be environment where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.
 - (vii) **Incorrect** A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as Data Analytics.
 - (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) Powers of C & AG in performance of his duties: The Comptroller and Auditor General's (Duties, Powers and Condition of Service) Act, 1971 gives the following powers to the C&AG in connection with the performance of his duties:
- (i) To inspect any an office accounts under the control of the union or a State Government including office responsible for creation of initial or subsidiary accounts.
 - (ii) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
 - (iii) To put such questions or make such observations as he may consider necessary to the person- in charge of the office and to call for such information as he may require for preparation of any account or report, which is his duty to prepare.

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transaction as he may determine.

(b) Fraud in the form of misappropriation of goods is still more difficult to detect; for this, management has to rely on various measures. Apart from the various requirements of record keeping about the physical quantities and their periodic checks, there must be rules and procedures for allowing persons inside the area where goods are kept. In addition there should be external security arrangements to see that no goods are taken out without proper authority. Goods can be anything in the premises; it may be machinery. It may even be the daily necessities of the office like stationery. The goods may be removed by subordinate employees or even by persons quite higher up in the management. Auditors can detect this by undertaking a thorough and strenuous checking of records followed by physical verification process. Also, by resorting to intelligent ratio analysis, auditors may be able to form an idea whether such fraud exists.

(c) When risks in IT systems are not mitigated the audit impact could be as follows:

- (i) The auditor may not be able rely on the reports, data obtained, automated controls, calculations and accounting procedures in the IT system.
- (ii) The auditor has to perform additional audit work by spending more time and efforts.
- (iii) The auditor may have to issue a modified opinion, if necessary.

(d) **Sample Selection:**

CA. X should obtain the knowledge before using the sampling methods. The principal methods are as follows:

- (1) Random selection.
- (2) Systematic selection.
- (3) Monetary Unit sampling.
- (4) Haphazard selection.
- (5) Block selection.

Advantages of Statistical Sampling in Auditing:

- (i) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- (ii) The sample selection is more objective and thereby more defensible.
- (iii) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- (iv) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
- (v) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

3. (a) **Information which assist the Auditor in accepting and continuing of relationship with Client:** As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The integrity of the principal owners, key management and those charged with governance

- of the entity;
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
 - (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
 - (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.
- (b) In establishing the overall audit strategy**, auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the reporting objectives of the engagement are:
- (i) The entity's timetable for reporting, such as at interim and final stages.
 - (ii) The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work.
 - (iii) The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
 - (iv) The discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- (c)** The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
- (a) Discuss the matter with management and, where appropriate, those charged with governance.
 - (b) Determine whether the financial statements need amendment and if so,
 - (c) Inquire how management intends to address the matter in the financial statements.
- (d)** Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

Analytical Procedures in Planning the Audit

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions.

4. (a) Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial

controls as, “the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”

From the above definition, it is clear that **internal financial controls are** the policies and procedures adopted by the company for:

1. ensuring the orderly and efficient conduct of its business, including adherence to company’s policies,
2. the safeguarding of its assets,
3. the prevention and detection of frauds and errors,
4. the accuracy and completeness of the accounting records, and
5. the timely preparation of reliable financial information.”

(b) Power and fuel expense -

- Obtain a month wise expense schedule along with the power bills.
- Verify if expense has been recorded for all 12 months.
- Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis.
- In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends.

(c) For Verification of Existence of Trade Receivables, the auditor should check the following :

- i. Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice.
Ask for a period-end accounts receivable aging report and trace the balance as per the report to the general ledger.
- ii. Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first.
- iii. If any large balance is due for a long time, auditor should ask for reasons and justification for the same.
- iv. A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed.
- v. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.
- vi. Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample.
The Com □
- vii. Where no reply is received, the auditor should perform alternate procedures regarding the balances. This could include:
- viii. Agreeing the balance to cash received subsequently;
- ix. Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions

and confirming that these revenue transactions actually occurred. (examination in depth for those balances)

- x. If there are any related party receivables, review them for collectability as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.
- xi. Check that receivables for other than sales or services are not included in the list.
- xii. Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e. perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers

5. (a) Examples of costs to be excluded in determining cost of Inventory:

In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

- (i) abnormal amounts of wasted materials, labour, or other production costs;
- (ii) storage costs, unless those costs are necessary in the production process prior to a further production stage;
- (iii) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- (iv) selling and distribution costs.

In the given situation, contention of Z Ltd. is not correct to include all the cost of its inventories while determining the cost of inventory. However, contention of accountant is correct that certain cost should be excluded from the cost of inventories and to be recognised as expenses in period in which they are incurred.

(b) Re-appointment of auditor: A retiring auditor may be re-appointed at an annual general meeting, if-

- (i) he is not disqualified for re-appointment.
- (ii) he has not given the company a notice in writing of his unwillingness to be re-appointed; and
- (iii) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
- (iv) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

(c) Matters to be included in Auditor's report as per CARO 2016:

- (i) Clause (viii) of Para 3 of CARO, 2016, requires the auditor to report whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

- (ii) Clause (x) of Para 3 of CARO, 2016, requires the auditor to report whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;
- (d) **Examples of circumstances to include Emphasis of Matter Paragraph:** As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are;
 - (a) An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
 - (b) A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
 - (c) Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
 - (d) A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- 6. (a) **Advances under Consortium:** Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

- (b) **Audit against Rules & Orders –** Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made there under. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- (a) they are not inconsistent with any provisions of the Constitution or any laws made there under;
 - (b) they are consistent with the essential requirements of audit and accounts as determined by the C&AG;
 - (c) they do not come in conflict with the orders of, or rules made by, any higher authority; and
 - (d) in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.
- (c) (i) **Revenue grants received by Local Bodies:**

Local bodies may receive different types of grants from the state administration. Broadly the revenue grants are of three types:

- (1) *General purpose grants:* These are primarily intended to substantially bridge the gap

between the needs and resources of the local bodies.

- (2) *Specific purpose grants*: These grants which are tied to the provision of certain services or performance of certain tasks.
- (3) *Statutory and compensatory grants*: These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

- (ii) **Propriety audit**: According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Further, it may so happen that a transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned but may still be highly wasteful.

In the given situation, PQR Ltd. being a government company, constructed a building in conformity with rules and regulations for installing a telephone exchange but not used for the same purpose resulting in an infructuous expenditure.

Thus, propriety audit should be done for PQR Ltd. to bring out improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations to the notice of the proper authorities of wastefulness in public administration.

- (d) **Certificate from a Management's Expert**: In the given case, SMP Limited has provided a sum of 20 lakh in the books of accounts as gratuity payable on the basis of certificate obtained from an actuary. The liability towards gratuity payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service, it is an ascertained present liability accruing over the period of service but payable upon cessation of service.

The auditor should check the quantification of the gratuity liability. He should ascertain whether the same had been actuarially determined. The auditor should treat the actuary as managements' expert and conduct procedures relevant to checking the opinion of an expert in accordance with SA 500.

As per SA 500, "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

1. Evaluate the competence, capabilities and objectivity of that expert;
2. Obtain an understanding of the work of that expert; and
3. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

- (e) **The objectives of the auditor regarding written representation:**

- (i) **To obtain written representations**

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(ii) To support other evidence

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

(iii) To respond appropriately

To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.