

PAPER – 6 : AUDITING AND ASSURANCE

QUESTIONS

Nature of Auditing

1. (a) Mention briefly the conditions or events, which increase the risk of fraud or error leading to material misstatement in Financial Statements.
(b) What are the obvious assertions in the following items appearing in the Financial Statements?
 - (i) *Profit and Loss Statement*

Travelling Expenditure	₹ 50,000
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 - (ii) *Balance Sheet*

Debtors	₹ 2,00,000
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2. (a) What are the inherent limitations of audit?
(b) What is the importance of having the accounts audited by an independent auditor?
 3. (a) Discuss the types of audits required under law.
(b) Discuss briefly relationship of Auditing with Behavioural Science.

Basic Concepts in Auditing

4. (a) What do you mean by the term 'Sufficient Appropriate Audit Evidence'? State various factors that help the auditor to ascertain as to what is sufficient appropriate audit evidence.
(b) 'A Joint Auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report.'
Justify this statement in the light of responsibilities of Joint Auditors under SA 299.
5. (a) Distinguish between Internal evidence and External evidence.
(b) What is meant by external confirmation? Mention four situations where external confirmation may be useful for auditors.
6. (a) Explain, what do you mean by Analytical procedures. How such procedures are helpful in auditing?
(b) "To ensure proper understanding of financial statements, it is necessary that all significant accounting policies in preparation and presentation of financial statements should be disclosed." Comment.

Preparation for an Audit

7. (a) In performing an audit of financial statements, the auditor should have or obtain knowledge of the business. Explain in the light of SA 315 "Identifying and Assessing

the Risks of Material Misstatement through Understanding the Entity and its Environment”.

- (b) Medical Council of India organised a three-day International Conference of Doctors in Delhi. You are asked to audit the accounts of the conference. Draft the audit programme for audit of receipt of participation fees from delegates to the conference. Mention any six points, peculiar to the situation, which you will like to include in your audit programme.
8. (a) What are audit working papers? Discuss various contents of Permanent Audit File and Current File.
- (b) What precautions should be taken by an auditor while applying test check techniques?

Internal Control

9. (a) “The overall objective and scope of an audit does not change in an EDP environment”. Comment
- (b) ‘Doing an audit in an EDP environment is simpler since the trial balance always tallies’ Analyse critically?
10. (a) What is an Audit Trail? Briefly state the special audit techniques using the computer as an audit tool.
- (b) The accountant of M/s Blisco was authorized to receive the payments from debtors. On one occasion, when he recovered bad-debt of ₹ 20,000 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) State the important elements of input control in processing of data in a computerised accounting system.
- (b) Being an auditor of a college, mention the points that you will consider to check whether a good internal control system for collection of tuition fees from students has been implemented or not.

Vouching & Verification of Assets and Liabilities

12. (a) Learn Well School, an educational institute deposits all of its collection/receipt in separate collection account of bank. Being an auditor mention any six points to be considered by you, while verifying the correctness of bank balance.
- (b) List out some examples of fraud that can be done by ledger keeper in Bought ledger and sales ledger.
13. How would you vouch/verify the following?
- (a) Rental Receipts.

- (b) Assets acquired on Hire-purchase.
 - (c) Cash Sales.
 - (d) Sale of Investments.
14. (a) Explain the meaning of the term “subsequent events” as used in the SA 560.
- (b) Should all type of subsequent events be considered by the auditor in his attest function?
- (c) Indicate briefly the procedures to identify subsequent events requiring adjustment of or disclosure in the financial statements.
15. State briefly the duty of an auditor with regard to each of the following:
- (a) XYZ Ltd., is engaged in the business of manufacturing of Cycle parts at Ludhiana. The company wants to change the method of depreciation on plant and machinery from SLM basis to WDV basis from the current year.
 - (b) M/s Hind Scientifics is engaged in the business of manufacturing & trading of scientific instruments. A sum of ₹ 10,00,000 is received from an Insurance company in respect of a claim for loss of goods in transit costing ₹ 8,00,000. The amount is credited to the Purchases Account.
 - (c) Malik Ltd. is carrying on its business of manufacturing handloom goods in its self owned property. Cost of structural alterations amounting to ₹ 60,000 to such self-owned factory premises has been charged to Building Repairs.
 - (d) Asian Crafts Ltd., is carrying on the business of manufacturing home décor items. A loss of ₹ 2,00,000 on account of embezzlement of cash was suffered by the company and it was debited to Salary Account.

The Company Audit

16. What will be position of the Auditor in the following cases?
- (a) Mr. Sehgal was appointed as auditor of M/s Lovani Impex Ltd in Annual General Meeting held in September 2012. Subsequently, Mr. Sehgal joined Mr. Maggo, another chartered accountant who is CFO of Lovani Impex Ltd, as partner.
 - (b) Dewan Ltd, in its Annual General Meeting held in September 2011, appointed Mr. Rubal as its auditor. In June 2012, Mr. Rubal was removed through a resolution in the General Meeting and company appointed Mr. Aditya as its auditor.
 - (c) Ms. Amisha, is the auditor of Vihaan Pvt. Ltd. In which there are four shareholders only, who are also the Directors of the company. On account of bad trade and for reducing the expenses in all directions, the directors asked Ms. Amisha to accept a reduced fee and for that she has been offered not to carry out such full audit as she has done in the past. Ms. Amisha accepted the suggestions of the directors.
 - (d) Mr. Ashok was appointed the auditor of Freeway Pvt. Ltd. While conducting the

audit for the year ended 31st March, 2012, Mr. Ashok wanted to refer to the Minute Books. The Board of Directors refused to show the Minute Books to the auditor.

17. (a) JKT Ltd. having ₹ 40 lacs paid up capital, ₹ 9.50 lacs reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being ₹ 4.90 crores, ₹ 4.50 crores and Rs. 6 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory. Comment.
- (b) Explain the difference between Unmodified opinion and and Qualified opinion.
18. State briefly, how you will audit the following in a joint stock company:
- (a) Alteration of Share Capital
- (b) Reduction of Capital

Special Audits

19. M/s GRS & Co have been appointed to audit the accounts of a Hospital in Delhi. What special steps will you as an auditor suggest to take into consideration in auditing the accounts of this hospital?
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. (a) In planning and performing his examination, the auditor should take into consideration the risk of material misstatements of the financial information caused by fraud or error. Weaknesses in the design of the internal control system and non-compliance with identified control procedures amongst other conditions or events which increase the risk of fraud or error are:
- (i) Weaknesses in the design of internal control system and non-compliance with the laid down control procedures, e.g., a single person is responsible for the receipt of all dak and marking it to the relevant sections or two persons are responsible for receipt of dak but the same is not followed in actual practice, etc.

- (ii) Doubts about the integrity or competence of the management, e.g., domination by one person, high turnover rate of employees, frequent change of legal counsels or auditors, significant and prolonged understaffing of the accounts department, etc.
 - (iii) Unusual pressures within the entity, for example, industry is doing well but the company is not performing accordingly, heavy dependence on a single line of product, inadequate working capital, entity needs raising share prices to support the market price in the wake of public offer, etc.
 - (iv) Unusual transactions such as transactions with related parties, excessive payment for certain services to lawyers, etc.
 - (v) Problems in obtaining sufficient and appropriate audit evidence, e.g., inadequate documentation, significant differences between the figures as per the accounting records and confirmation received from third parties, etc.
- (b) (i) **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.
- (ii) **Debtors: ₹ 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.
2. (a) **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.

- (b) Advantages of having the accounts audited by an independent auditor are:-
- (i) It safeguards the financial interest of persons not associated with the management like partners or shareholders.
 - (ii) It acts as a moral check on the employees from committing fraud.
 - (iii) It is helpful in settling tax liability, negotiations for loans and for determining purchase consideration for sale/merger.
 - (iv) It is also helpful in settling trade or labour disputes for higher wages/bonus.
 - (v) It helps in detection and minimizing wastages and losses.
 - (vi) It ensures maintenance of adequate books and records, statutory register etc.

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, 1956;
 - (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) **Auditing and Behavioural Science:** The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

4. (a) Meaning of sufficient appropriate audit evidence: The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

SA 500 on 'Audit Evidence' further expounds this concept. According to it, the sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

SA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. Further, SA 200 contains discussion of such matters as the nature of audit procedures, the timeliness of financial reporting, and the balance between benefit and cost, which are relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained.

In general the various factors which may influence the auditor's judgment as to what is sufficient and appropriate audit evidence are as under:

- (i) Degree of risk of misstatements which may be affected by factors such as the nature of items, adequacy of internal control, nature and size of businesses carried out by the entity, situations which may exert an unusual influence on management and the financial position of the entity.

- (ii) The materiality of the item.
 - (iii) The experience gained during previous audits.
 - (iv) The results of auditing procedures, including fraud and errors which may have been found.
 - (v) The type of information available.
 - (vi) The trend indicated by accounting ratios and analysis.
- (b) **Responsibility of Joint Auditors:** SA 299 on, "Responsibility of Joint Auditors" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. The responsibilities of joint auditors, as a rule are no different from the responsibilities of individual auditors as enumerated in the Companies Act, 1956. Main features of the said SA are discussed below:
- ◆ **Division of Work:** Where joint auditors are appointed, they should, by mutual discussion, divide the audit of identifiable units or specified areas. Certain areas of work, owing to their importance or owing to the nature of work involved would not be divided and would be covered by all the joint auditors. Such a division affected by the joint auditors should be adequately documented and preferably communicated to the auditee.
 - ◆ **Coordination:** Where in the course of his work, a joint auditor comes across matters which are relevant to the areas of other joint auditors and which require joint discussion, he should communicate the same to all the other joint auditors in writing before the finalisation of audit and preparation of audit report.

In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

- (i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (ii) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors.
- (iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and

- (v) for ensuring that the audit report complies with the requirements of the relevant statute.
- (vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit.
- (vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors.
- (viii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are able to arrive at an agreed report. However where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

5. (a) **Internal evidence and external evidence:** Evidence which originates within the organization being audited is internal evidence. Example – sales invoice, copies of sales challan and forwarding note, goods received notes, inspection report, copies of cash memo, debit and credit notes, etc.

External evidence on the other hand is the evidence that originates outside the client's organization; for example, purchase invoice, supplier's challan and forward note, debit notes and credit notes coming from parties, quotations, confirmations, etc.

In an audit situation, the bulk of evidence that an auditor gets is internal in nature. However, substantial external evidence is also available to the auditor. Since in the origination of internal evidence, the client and his staff have the control, the auditor should be careful in putting reliance on such evidence. It is not suggested that they are to be suspected; but an auditor has to be alive to the possibilities of manipulation and creation of false and misleading evidence to suit the client or his staff. The external evidence is generally considered to be more reliable as they come from third parties who are not normally interested in manipulation of the accounting information of others. However, if the auditor has any reason to doubt the independence of any third party who has provided any material evidence e.g., an invoice of an associated concern, he should exercise greater vigilance in that matter. As an ordinary rule the auditor should try to match internal and external evidence as far as practicable. Where external evidence is not readily available to

match, the auditor should see to what extent the various internal evidence corroborate each other.

- (b) **External confirmation:** As per SA 505 “External Confirmations” Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

The auditor should determine whether the use of external confirmation is necessary to obtain sufficient appropriate audit evidence to support certain financial statement assertions. Following are examples of situations where external confirmations may be useful.

- (i) Bank balances and other information from bankers
- (ii) Account receivables balances
- (iii) Stock held by third parties
- (iv) Account payable balances.

6. (a) **SA 520 ‘Analytical Procedures’:** As per SA 520 the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. The auditor’s choice of procedures, methods and level of application is a matter of professional judgement.

Analytical procedures include the consideration of comparisons of the entity’s financial information with, for example: comparable information for prior periods, anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation and similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example: among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages and Between financial information and relevant non-financial information, such as payroll costs to number of employees.

Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

Analytical procedures are used for the following purposes:

- (a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
 - (b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.
- (b) **Disclosure of Accounting Policies:** The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements.

The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated. The disclosure of some of the accounting policies followed in the preparation and presentation of the financial statements is required by some cases.

The purpose of AS 1 is to promote better understanding of financial statements by establishing through an accounting standard and the disclosure of significant accounting policies and the manner in which such accounting policies are disclosed in the financial statements.

Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. Such disclosure should form part of the financial statements.

It would be helpful to the reader of financial statements if they are all disclosed at one place instead of being scattered over several statements, schedules and notes which form part of financial statements.

Any change in accounting policy, which has a material effect, should be disclosed. The amount by which any item is in the financial statement is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies, which has not material effect on the financial statements for the current period, which is reasonably expected to have material effect in latter periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

7. (a) **Obtaining Knowledge of the business** : The auditor needs to obtain a level of knowledge of the client's business that will enable him to identify the events, transactions and practices that, in his judgment, may have significant effect on the financial information among other things.

As per SA 315 – "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", the auditor shall obtain an understanding of the following:

- (i) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework
- (ii) The nature of the entity, including:
 - (1) its operations;
 - (2) its ownership and governance structures;
 - (3) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 - (4) the way that the entity is structured and how it is financed;to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
- (iii) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
- (iv) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
- (v) The measurement and review of the entity's financial performance.

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgement regarding the appropriateness of accounting policies and disclosures.

- (b) **Audit of Receipts of Participation Fees** : The organization of three-day International Conference of Doctors in Delhi by Medical Council of India is a one-time event. Normally, in view of mega-size of the event, a special cell is made in the organization to handle the entire event. Since few people would be handling the event, the internal controls may not be that strong and, thus, more emphasis is required to be given on substantive procedure. Audit of receipt of participation fees should be under the following areas:

(i) Internal Control System

- (1) Examine the organization structure of special cell created for the International Conference, if any, and division of responsibilities amongst persons and control/custody over receipt books.
- (2) Verify the internal control system for restricting the participation of unregistered delegates.

(ii) Rate of Participation Fees

- (1) Verify with reference to resolution passed by the Organizing Committee/Medical Council of India.
- (2) Also verify the rate from the literature/registration form circulated for promotion of conference.

(iii) Receipts of Participation Fees

- (1) Verify counter foil of the receipts issued for individual registration.
- (2) Ensure that receipts are issued for all the registration received in cash.
- (3) Trace the receipts in Bank Statement or Cash Book – as the case may be.
- (4) Verify Bank Reconciliation Statement and list out dishonoured cheques.
- (5) Verify subsequent recovery in respect of dishonoured cheques.

(iv) Overall Checking

- (1) Verify the total receipts of participation fees shown in the financial statements with reference to total number of receipts issued to participants.
- (2) Cross check the total number of delegates with reference to the following:
 - (a) Kits distributed to participants.
 - (b) Bill of caterer for providing meals during conference.
 - (c) Capacity of the Hall.
 - (d) Participation Certificate if any issued.

(v) Foreign Delegates: In case of foreign delegates – if registration fees are higher – ensure that they are registered at higher fees.**(vi) Special Issues**

- (1) Take out list of absentees and in case of nil absentees, probe the issue further.
- (2) If certain participants are exempted from payment of fees – obtain the list along with proper authorization in this regard.

8. (a) **Audit Working Papers:** Working papers are papers prepared and obtained by the auditor and retained by him, in connection with the performance of his audit. Working papers are the property of the auditor. As per SA 230 "Audit Documentation" refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "work papers" are also sometimes used).

Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.

In case of recurring audits, auditors generally prepare two types of audit files.

(i) **Permanent Audit file: It includes –**

- (1) Information concerning the legal and organisational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.
- (2) Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
- (3) A record of the study and evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
- (4) Copies of audited financial statements for previous years.
- (5) Analysis of significant ratios and trends.
- (6) Copies of management letters issued by the auditor, if any.
- (7) Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
- (8) Notes regarding significant accounting policies.
- (9) Significant audit observations of earlier years.

(ii) **Current Audit file:** The current file normally includes:

- (1) Correspondence relating to acceptance of annual reappointment.
- (2) Extracts of important matters in the minutes of Board Meetings and General Meetings, as are relevant to the audit.
- (3) Evidence of the planning process of the audit and audit programme.
- (4) Analysis of transactions and balances.
- (5) A record of the nature, timing and extent of auditing procedures performed and the results of such procedures.

- (6) Evidence that the work performed by assistants was supervised and reviewed.
- (7) Copies of communications with other auditors, experts and other third parties.
- (8) Copies of letters or notes concerning audit matters communicated to or discussed with the client, including the terms of the engagement and material weaknesses in relevant internal controls.
- (9) Letters of representation or confirmation received from the client.
- (10) Conclusions reached by the auditor concerning significant aspects of the audit.
- (11) Copies of the financial information being reported on and the related audit reports.

(b) While adopting test check technique, an auditor should take following precautions:-

- (i) The transactions of the concern should be classified under appropriate heads and may be stratified in case of wide variations between the transactions of the same kind.
 - (ii) Authorisations, documentations, recording of the transactions should be studied right from the beginning to end.
 - (iii) Evaluating the system of internal control for its efficiency, soundness and capability to produce reliable accounting and financial data.
 - (iv) Preparation of test check plan with clear audit objective understood by the audit staff.
 - (v) Un-biased selection of the transactions with reference to the random number tables or other statistical methods.
 - (vi) Identification of the areas where test check may not be done.
 - (vii) Based on degree of reliance and the confidence level required in the audit, the number of transactions to be selected for each test plan should be pre-determined.
 - (viii) Setting up criteria to judge what constitute material or immaterial errors. Further investigation of only material errors be carried out and all immaterial errors may be avoided.
9. (a) The principal objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to ensure that the financial statements reflect a true and fair view. The scope of an audit of financial statements is determined by the auditor

having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute. This would involve assessment of reliability and sufficiency of the information contained in the accounting records and other source data by study and evaluation of accounting system and internal controls in operation.

The overall objective and scope of an audit does not change in an EDP environment but the use of a computer changes the processing and storage of financial information and may affect the organisation and procedures employed by the entity to achieve adequate internal control. Accordingly, the procedures followed by the auditor in his study and evaluation of the accounting system and related internal controls and nature, timing and extent of his other audit procedures may be affected by an EDP environment. The computerisation of accounts would also have an impact on the increase in fraud and errors. Thus when auditing in an EDP environment, the auditor should have sufficient understanding of computer hardware, software and processing systems to plan the engagement and to understand how EDP affects the study and evaluation of internal control and application of auditing procedures including computer-assisted audit techniques. The auditor should also have sufficient knowledge of EDP to implement the auditing procedures, depending on the particular audit approach adopted.

Thus, it is clear from the above that overall objective and scope of audit does not change irrespective of fact that whether the accounting information is generated manually or through EDP.

- (b) **Audit in EDP environment:** Though it is true that in EDP environment the trial balance always tallies, the same can not imply that the job of an auditor becomes simpler. There can still be some accounting errors like omission of certain entries, compensating errors, duplication of entries, errors of commission in the form of wrong A/c head is posted., possibility of "Window Dressing" and/or "Creation of Secret Reserves" where the trial balance tallied . . . At present, due to complex business environment the importance of trial balance cannot be judged only upto the arithmetical accuracy but the nature of transactions recorded in the books and appear in the trial balance should be focused.

The emergence of new forms of financial instruments like options and futures, derivatives, off balance sheet financing etc have given rise to further complexities in recording and disclosure of transactions. In an audit, besides the tallying of a trial balance, there are also other issue like estimation of provision for depreciation, valuation of inventories , obtaining audit evidence, ensuring compliance procedure and carrying out substantive procedure, verification of assets & liabilities their valuation etc. which still requires judgement to be exercised by the auditor.

Responsibility of expressing an audit opinion and objectives of an audit are not changed in the audit in EDP environment. Therefore, it can be said that simply

because of EDP environment and the trial balance has tallied it does not mean that the audit would become simpler.

10. (a) **Audit Trail:** 'Audit trail' refers to a situation where it is possible to relate, on a "one – to –one" basis, the original input with the final output. In a manual accounting system, it is possible to relate the recording of a transaction of each successive stage enabling an auditor to locate and identify all documents from beginning to end for the purposes of examining documents, totalling and cross – referencing. In first and early second generation computer systems, a complete audit trail was generally available. However, with the advent of modern machines, the EDP environment has become more complex. This led to use of exception reporting by the management which effectively eliminated the audit trail between input and output. The lack of visible evidence may occur at different stages in the accounting process, for example:

- (i) Input documents may be non-existent where sales orders are entered online. In addition, accounting transactions such as discounts and interest calculations may be generated by computer programmes with no visible authorization of individual transactions.
- (ii) The system may not produce a visible audit trail of transactions processed through the computer. Delivery notes and suppliers invoices may be matched by a computer programme. In addition, programmed control procedures such as checking customer credit limits, may provide visible evidence only on an exception basis. In such cases, there may be no visible evidence that all transactions have been processed.
- (iii) Output reports may not be produced by system or a printed report may only contain summary totals while supporting details are retained in computer files.

Special audit Techniques: In the absence of audit trail, the auditor needs the assurance that the programmes are functioning correctly in respect of specific items by using special audit techniques. The absence of input documents or the lack of visible audit trail may require the use of Computer Assisted Audit Techniques (CAATs) i.e. using the computer as an audit tool. The auditor can use the computer to test:

- the logic and controls existing within the system, and
- the records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor. The effectiveness and efficiency of auditing procedure may be enhanced through the use of CAATs. Properly, two common types of CAATs are in vogue, viz., test pack or test data and audit software or computer audit programmes.

- (b) 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:

- (1) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.
- (2) It also appears that system for issuing receipts for amount received - whether cash or cheque is also lacking.
- (3) 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) Control over input in a computerized accounting system

- (i) The input fed into the computer should be authorized. The authorization levels should be checked. The authorization is effected by levels of access to the entry for the computer system. The access control is operated through use of password and logging procedures.
- (ii) The system should devise controls to check that data input are accurate.
- (iii) The input document should be reviewed and verified by another person after preparation.
- (iv) Transaction should be accurately converted into machine readable language and recorded in a computer data file.
- (v) The transactions are not lost, duplicated, or changed without authorization.
- (vi) There should be validity and cross reference checks inbuilt in the system to throw light on errors which appear in the process of feeding input.
- (vii) Incorrect transactions are thrown out by a list which must be corrected, resubmitted before the process could run on the inputs.
- (viii) The check digit total of financial information contained in the document or hash total may be used to act as a control tool.
- (ix) The serial control may be used in inputting data that are to follow serial sequence. Any deviation in serial sequence will have to be automatically signaled out.

(b) Internal control points for collection of tuition fees:

- (i) There must be a clear cut tuition fee structure approved by the college council.
- (ii) The challan or paying in slip should contain necessary fields for identifying the roll number of the student, class, and period for which fees is paid etc. The slips should have such number of counterfoils to cross check the remittance.
- (iii) The paying in slip when filled by the students, should be checked for its correctness as to applicable amount etc by one clerk and the amount should be entered in a scroll. He must initial the slip which authorises the cashier to accept the fees as per slip.
- (iv) The cashier scroll and the authorising officer/s scroll should be checked by an officer daily.
- (v) All remittance should be banked each day. No amount should be allowed to be spared for meeting any type of expense.
- (vi) Alternatively, the fees may be directly remitted into bank and banker's daily remittance slip should be scrutinised by college officers.
- (vii) Arrears list should be periodically prepared from the students rolls. Any concession, remission of tuition fees should have approval of competent authority.
- (viii) Delayed remittance should carry fines or compensating charges for delay.
- (ix) When students are readmitted after removal for non-payment of fees, the admission should carry the permission of competent authority.

12. (a) For verifying the balances lying with bank in collection account, the auditor should adopt following procedure:

- (i) Examine and compare the pay-in-slips with the entries in the ledger account of the educational institute.
- (ii) Check the casting, carry forwards and balancing of ledger account.
- (iii) Compare the entries in the ledger account with the bank statement.
- (iv) Review the bank reconciliation statement for its correctness.
- (v) Scrutiny the subsequent period bank statement to ensure that items of reconciliation are subsequently cleared.
- (vi) Verify the balance confirmation certificate.

(b) Ledger Keeper & Frauds

Examples of frauds that can be done by ledger keeper in bought ledger:

- (i) Crediting the account of a supplier on the basis of a fictitious invoice, showing that certain supplies have been received from the firm, whereas in fact no

goods have been received or on the basis of duplicate invoice from a supplier, the original amount whereof has already been adjusted to the credit of the supplier in the Bought Ledger, and subsequently misappropriating the payment made against the credit in the supplier's accounts.

- (ii) Suppressing a credit note issued by a supplier in respect of return or an allowance and misappropriating an amount equivalent thereto out of the payment made to him. For if a credit note issued by a supplier either in respect of goods returned to him or for an allowance granted by him, is not debited to his account, the balance in his account in the Bought Ledger would be larger than the amount actually due to him. The ledger-keeper thus will be able to misappropriate the excess amount standing to the supplier's credit.
- (iii) Crediting an amount due to a supplier not in his account but under a fictitious name and misappropriating the amount paid against the credit balance.

Examples of frauds that can be done in sales ledger:

- (i) Teeming and Lading: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. Similarly, moneys received from the customer who has paid thereafter being credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time, which may lead the management to either send out a statement of account to him or communicate with him.
- (ii) Adjusting an unauthorised credit or fictitious rebate, allowance, discount, etc. in the account with a view to reduce the balance and when payment is received from the debtor, misappropriating an amount equivalent to the credit.
- (iii) Writing off the amount receivable from a customer's bad debt account and misappropriating the amount received in payment of the debt.

13. (a) Rental Receipts

- (i) Check copies of bills or rent receipt issued to the tenant with reference to tenancy agreement and bills of charges paid by the landlord on behalf of tenants.
- (ii) The entries in the rental register in respect of rent accrued should be traced with reference to copies of rental bills.
- (iii) Scrutinize the account of collecting agent when the rent is collected by such agent.
- (iv) Vouch the entries for rent received in advance and ensure proper adjustment is made.

- (v) Investigate into abnormal rent outstanding.
 - (vi) Reconcile the outstanding rent and see that proper provision is made if unrecoverable.
 - (vii) If rent is received net of TDS, see that rent income is shown at gross and TDS is shown in Balance Sheet as advance Tax.
- (b) Assets acquired on Hire purchase**
- (i) Inspect the hire purchase agreement to ascertain the terms and condition, the installment and amount of interest included in the installment.
 - (ii) Ensure that these are treated as assets acquired under finance lease as per AS-19.
 - (iii) Verify that initial recognition of lease should be as an asset and a liability at equal amounts.
 - (iv) If it is reasonably certain that lessee will get ownership at the end of the term, see that asset is depreciated over its useful life. Otherwise confirm that asset is depreciated over the shorter of its useful life and the lease term.
 - (v) Ensure that it is shown separately in the Balance Sheet.
- (c) Cash Sales**
- (i) Examine the system of internal check to ascertain any loopholes therein.
 - (ii) Ascertain the practice followed in the matter of issuing cash memos and trace the memos into cash sale summary.
 - (iii) Ensure that the date of cash memos tally with the entry in the cash book/summary.
 - (iv) Verify that prices of goods sold have been correctly recorded and check the calculation.
 - (v) Verify the entry in the goods outward book with the sales summary.
 - (vi) See that the cancelled cash memos are not removed from the receipt book.
- (d) Sale of Investments**
- (i) See that sale of investment has been made on the proper authorisation of Board or other competent authority.
 - (ii) Ascertain the method of selling investments. It may be either through broker, directly or through a bank. See the broker's sold note.
 - (iii) See that the difference between the carrying amount and the sales proceeds, net of expenses, is recognised in the Profit & Loss Account. Ensure that when only a part of the holding of an individual investment is sold, the carrying

amount is allocated on the basis of average carrying amount of the total holding of the investments.

- (iv) See that proper disclosures as required by AS 13 are made as follows:
 - (1) Interest, dividends, rentals on investments are to be shown in P& L A/c at Gross Value and TDS as advance tax paid.
 - (2) Showing separately profit & Loss on disposal and changes in carrying amount of current and long term investments.

14 (a) **Meaning of Subsequent Events:** SA 560 on "Subsequent Events", defines the term "subsequent events" as events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report., "subsequent events" also refer to significant events which occurred upto the date of report of the auditor of that component. Thus, subsequent events are those events which occur after the date of the balance sheet till the audit report is signed by the auditor.

(b) **Consideration of Subsequent Events by the Auditor:** SA 560 requires that the auditor should consider the effect of subsequent events on the financial statements and the auditor's report. However, the exact manner of treatment would depend upon whether the event falls in the category of 'adjusting event' or 'non-adjusting event'. As per Accounting Standard (AS) 4, events occurring after the date of the balance sheet are of two types, viz., adjusting events which provide further evidence of conditions that existed at the date of the balance sheet; and, non-adjusting events are those which are indicative of conditions that arose subsequent to the date of the balance sheet.

Therefore, an auditor is required to consider all subsequent events while discharging his duties and determine whether those shall have to be adjusted or simply required to be disclosed. However, the auditor should perform work as near as practicable to the date of the auditor's report.

(c) **Audit Procedures:** The auditor should perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified. The procedure to identify "subsequent events" requiring adjustment or disclosure in financial statements as laid down in SA 560 is as under:

- (i) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- (ii) Inquiring of management and, where appropriate, those change with governance as to whether any subsequent events have occurred which might affect the financial statements.

Examples of inquiries of management on specific matters are:

- Whether new commitments, borrowings or guarantees have been entered into.
- Whether sales or acquisitions of assets have occurred or are planned.
- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- Whether there have been any developments regarding contingencies.
- Whether there have been any developments regarding risk areas and contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.
- Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
- Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
- Whether any events have occurred that are relevant to the recoverability of assets.
 - (1) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
 - (2) Reading the entity's latest subsequent interim financial statements, if any.
 - (3) Read the entity's latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.
 - (4) Inquire, or extend previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims; or
 - (5) Consider whether written representations covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.

When the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements. If such events have not been

considered by the management and which in the opinion of the auditor are material, the auditor shall modify his report accordingly.

15. (a) As per "Accounting Standard 6 Depreciation Accounting", the method of depreciation should be applied consistently to provide comparability of the results of the operations of the enterprise from period to period. A change from one method of providing depreciation to another is made only if:

The adoption of the new method is required by statute (or)

For compliance with an accounting standard (or)

It is considered that the change would result in a more appropriate presentation of financial statements of the enterprise.

Therefore, the auditor must ensure that the change in method of depreciation on plant and machinery from SLM to WDV basis from the current year is made in accordance therewith. When such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. Further, it should be ensured that the deficiency (since change is from SLM to WDV) arising to be adjusted in the year of change by way of a charge to the profit and loss account. The auditor may also ascertain that the change in the method and the effect thereof on the profits of the entity is quantified and disclosed. If it is not done by the management, the auditor has to bring it to the notice of the shareholders through qualification in the audit report.

- (b) AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that all items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period. The claim for loss of goods in transit is arising out of ordinary activities of the enterprise as a part of its normal course of business. However, the cost of goods lost in transit is only ₹ 8,00,000 while the insurance money received is ₹ 10,00,000. Purchases Account need not be credited since it would distort the purchases done during the year and as also the gross profit. Therefore, entire amount of ₹ 10 lacs needs to be taken to profit and loss account under an appropriate head. This is an income arising from an ordinary activity of the enterprise but having regard to amount involved and exceptional nature, a separate disclosure be made in the profit and loss account. Such disclosure would enable the users to understand the performance of an enterprise for the period.
- (c) Any subsequent expenditure on fixed assets which increases the profitability or capacity arising from them beyond their previously assessed standards of performance amounts to capital expenditure and, thus, must form part of the cost of the asset. The words "structural alteration" would generally signify that some significant changes have taken place in the design of building to provide more strength to the building or expansion in the capacity of the building. Therefore, cost

of ₹ 60,000 represents the cost of expansion or extension or may increase the life span of premises, it is a capital expenditure, and an adjustment entry debiting Buildings Account and crediting Building Repairs Account should be made and depreciation should also be provided accordingly.

- (d) AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", requires that "all items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period". It further states that "when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately". Embezzlement of cash during the course of business is a 'business loss'. It is a business hazard which can occur once in a while. Being material item, it is required to be disclosed under a distinct head in the profit and loss account.
16. (a) **Disqualifications of an Auditor:** Section 226(3)(c) of the Companies Act, 1956 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (5) of Section 226 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) and (4) of Section 226, he shall be deemed to have vacated his office as an auditor. In the present case, Mr. Sehgal, an auditor of Lovani Impex Ltd, joined as partner with Mr. Maggo, who is CFO of M/s Lovani Impex Ltd, has attracted clause (3) (c) of Section 226 and, therefore, he shall be deemed to have vacated office of the auditor of M/s Lovani Impex Ltd.
- (b) **Removal of an Auditor:** The removal of auditor Mr. Rubal, a chartered accountant, before the expiry of the term of an auditor's appointment by Dewan Ltd is invalid. Sub-section (7) of Section 224 of the Companies Act, 1956 provides that an auditor may be removed from office before the expiry of his term, by the company only in a general meeting after obtaining the prior approval of the Central Government in that behalf.
- However such approval is not required for the removal of the first auditor appointed by the Board of Directors under the proviso to sub-section (5) of Section 224. Since prior approval of the Central Government has not been obtained, the removal of Mr. Rubal is not valid and, therefore, Mr. Rubal continues to be the auditor. The appointment of Aditya in his place is void.
- (c) **Restricting Scope of Audit:** Ms. Amisha may agree to temporary reduction in audit fees, if she so wishes, in view of the suggestions made by the directors (perhaps in accordance with the decision of the company taken in general meeting). But her duties as a company auditor are laid down by law and no restriction of any kind can

restrict the scope of her work either by the director or even by the entire body shareholders.

There is no concept of full or part audit under Section 227 of the Companies Act, 1956. And, remuneration is a matter of arrangement between the auditor and the shareholders. Section 224(8) specifies the remuneration of an auditor, shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

Her duties may not necessarily commensurate with her remuneration. Ms. Amisha, therefore, should not accept the suggestions of the directors regarding the scope of the work to be done. Even if Ms. Amisha accepts the suggestions of the directors regarding the scope of work to be done, it would not reduce her responsibility as an auditor under the law. Under the circumstances, Ms. Amisha is violating the provisions of the Companies Act, 1956.

- (d) **Right of Access to Minute Books:** Section 227 of the Companies Act, 1956 grants powers to the auditor that every auditor has a right of access, at all times, to the books and account including all statutory records such as minute books, fixed assets register, etc. of the company for conducting the audit.

In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company.

It is, therefore, essential for the auditor to refer to the Minute Books. In the absence of the Minute Books, the auditor may not be able to vouch/verify certain transactions of the company.

In case the directors have refused to produce the Minute Books, the auditor may consider extending the audit procedure as also consider qualifying his report in any appropriate manner.

17. (a) **Internal Audit System and CARO, 2003:** As per Para 4(vii) of CARO, 2003, statutory auditor is required to comment on whether the auditee company has an internal audit system commensurate with its size and nature of its business.

The clause has a mandatory application in respect of listed companies. For other companies, it is applicable if either of the following conditions is satisfied:

- (i) The company has a paid-up capital and reserves exceeding ₹ 50 lakhs at the commencement of the financial year, or
- (ii) The company has an average annual turnover of ₹ 5 crores or more for a period of 3 years preceding the current financial year.

In the instant case, the second condition has been fulfilled by JKT Ltd. Hence, the auditor will have to mention in his report the fact of not having such internal audit in his report by the Company.

- (b) The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

The auditor shall express a qualified opinion when:

- (i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

18. (a) **Alteration of Share Capital** A company, having a share capital, if so authorised by its Articles, may alter its share capital by an ordinary resolution without confirmation of the Court, in any of the manners authorised by Section 94. Each alteration made should be noted in every copy of the Memorandum and Articles issued subsequent to date of the alteration (Section 40). The auditor's duties in the circumstances shall be:

- (i) to verify that the alteration of capital is authorised by the Articles;
- (ii) to inspect the minutes of the shareholders authorising the alteration;
- (iii) to obtain Allotment Lists containing details of the new holdings of share or stock by each member and to verify the same with the entries.
- (iv) to inspect the directors' resolution in regard to allotment, consolidation, conversion or sub-division passed pursuant to the resolution of the members;
- (v) to examine the cancelled share certificates, if any, and agree the same with the counterfoils of new certificates issued;
- (iv) to see that the procedure, prescribed by the Articles in this regard, has been complied with;
- (vii) to verify that the share capital account is correctly shown in the Balance Sheet; and
- (viii) to see that the necessary intimation to the Registrar contemplated by Section 95 has been sent.

- (b) **Reduction of Capital (Section 100):** The duties of the auditor in this regard are following:

- (i) Verifying that the meeting of the shareholder held to pass the special resolution was properly convened; also that the proposal was circularised in advance among the members.
 - (ii) Confirming that the Articles of Association authorise reduction of capital.
 - (iii) Examining the order of the Tribunal confirming the reduction and seeing that a copy of the order and the minutes have been registered and filed with the Registrar of Companies.
 - (iv) Inspecting the Registrar's Certificate as regards reduction of capital.
 - (v) Vouching the journal entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also seeing that the requirements of Revised Schedule VI, Part I, have been complied with.
 - (vi) Confirming that the revaluation of assets have been properly disclosed in the Balance Sheet.
 - (vii) Verifying the adjustment made in the members' accounts in the Register of Members and confirming that either the paid up amount shown on the old share certificates have been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled.
 - (viii) Confirming that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
 - (ix) Verifying that the Memorandum of Association of the company has been suitably altered.
19. Audit of Hospital: The audit points to be considered by the auditor during the audit of a Hospital are stated below:-
- (i) 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) Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
 - (iii) 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 settled on the hospital, has been collected.

- (iv) Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
 - (v) 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) Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
 - (vii) 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) 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) 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 Stock Register and that issues have been made only against proper authorisation.
 - (x) See that depreciation has been written off against all the assets at the appropriate rates.
 - (xi) Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
 - (xii) Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
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.