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Ans.1 (a) Shares Issued at a Discount

As per provisions of Section 79 of The Companies Act 1956, a company can issue shares at a discount on the following conditions :

(i) The issue should be authorised by an ordinary resolution of the company and sanctioned by the Central Government.

(ii) No such resolution shall be sanctioned by the Central Government in case the maximum rate of discount should exceed 10 per cent unless the Central Government is of opinion that a higher rate for discount is justified by the special circumstances of the case.

(iii) The issue should be made within two months of the sanction by the Central Government but not earlier than one year after the date of commencement of business.

(iv) The shares should be of a class already issued by the company.

It is the duty of the auditor to confirm that all the conditions aforementioned have been complied with by the company at the time the allotment was made.

Though there appears to be no obligation on the part of the company to write off discount on the issue of shares, it is nonetheless advisable that is should be so done within a few years of the shares being issued. The amount of discount, until written of, should be shown separately in the Balance Sheet under the head "Miscellaneous Expenditure".

Ans.1 (b) CEILING ON NUMBER OF AUDITS

As per provisions of Section 224(1B) of The Companies Act 1956,

❅ No company or its board of director shall appoint or reappoint any person or firm as its auditor; if such person or firm, at the date of appointment;
  - ➢ Is in full time employment elsewhere, or
  - ➢ Is holding appointment as auditor of the/more than specified number of companies.

❅ The maximum limit of company audit is 20 companies per person. Out of which not more than 10 should be companies having paid up capital of Rs. 25 lacs or more.

❅ In case of a partnership firm, the limit is 20 companies per partner who is not in full time employment elsewhere.

❅ If a chartered accountant is partner in more than one firms or he is partner as well proprietor, the limit still is 20 companies per person.

❅ Manner of calculating ceiling limit [Explanation to section 224(1C)]

INCLUDED	**EXCLUDED**
Part Audit	Branch Audit
Joint audit	Corporations which are not company
Audit of Sec. 25 Company.	Foreign company
Audit of Govt. Co.	Guarantee co. not having share capital
	Special audit
`	Private company.

Ans.1 (c) Purposes of Providing Depreciation

(a) To keep capital intact : It will be evident that one of the effects of providing for depreciation on an asset is to retain in the business out of the profits in each year, an amount equal to the proportion of the cost of the asset employed in the business that has run off, estimated on the basis of the period of its working life and its scrap value. If, on the contrary, depreciation had not been charged, the net income would have been overstated over the years of the life of the asset, and if the same was withdrawn or distributed as dividends, the business would have no funds for the replacement of the asset.

(b) To ascertain cost accurately : Unless a proper charge on account of depreciation is included in the Profit and Loss Account, the true cost of manufacture of different products will not be ascertained. This is because depreciation is as much a charge against revenue as any other expenditure and must be included in accounts irrespective of the fact whether the final result of a working is profit or loss.

(c) To charge initial costs against earnings : The cost of a machine less its scrap value can, in effect, be regarded as the price for use of the machine paid in advance for the period it will be rendering service. According to this view unless an appropriate part of this price is charged to the profits of the business each year, the profit earned on its working will not be correctly ascertained.

(d) To prepare true and fair statements: Unless depreciation is provided, the assets will be shown at an mount higher than their true value and the profit shown will be more than the real profit. In other words, the Balance Sheet and the Profit and Loss Account will not be true and fair.

Ans.1 (d) As per provisions of Section 224(6) of The Companies Act 1956, A casual vacancy in the office of the auditor can be filled by the Board of Directors, provided such vacancy has not been caused by the resignation of the auditor. In case of a casual vacancy arising on account of resignation, only the company in general meeting can fill the vacancy by appointing another auditor. The expression 'casual vacancy' has not been defined in the Act. Taking its natural meaning, it stands for a vacancy created by the auditor ceasing to act after he was validly appointed and the appointment was accepted. This may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the firms of auditors, etc. The provision to require the filling of casual vacancy caused by resignation of the auditor by the general meeting is in consonance with the principle of auditor's independence. The process may bring out facts regarding the auditor's resignation to the notice of, and hence scrutiny by the shareholders. Any abuse of authority or financial impropriety by the management that might have contributed to the resignation will be known. If the auditor could be found to be conscientious and honest, the general meeting may even request him to reconsider his decision and take appropriate steps to cure the evils, if any, in the management. The auditor appointed to a casual vacancy shall hold office till the conclusion of the next annual general meeting.

Ans.2 (a) **<u>CONCEPT OF TRUE & FAIR</u>**

Under this concept auditor is required to express his opinion as to whether financial statement are truly & fairly represented, thus the auditor has to review all the assets, liability, income & expenses to arrive at such opinion.

The concept of True & Fairness is more fundamental & appropriate concept as against traditional concept of True & Correct. Financial statement could be free from any mathematical mistakes & be correct but still may not be 'fair'. Correctness is directly governed by mathematical accuracy whereas fairness is related to appropriate presentation, compliance of statutory requirements & accounting standards as well.

On the other hand small mistakes could make the financial statements incorrect but still they can be 'fair' unless the mistake is material enough to distort the financial position or operating results.

<u>Some provisions of Companies Act which ensures true & fairness :</u>

i) Section 211(1) & (2) states that financial statements of a company shall not deemed to be true & fair if they are not prepared in accordance with Schedule VI [Part I & II]

ii) Section 209(3) states that financial statements of a company are not true & fair if the books of accounts are not maintained on accrual basis.

<u>General considerations of true & fair view :</u>

i) No asset or liability should be undervalued / under stated or overvalued / overstated more than that warranted by circumstances.

ii) No material assets or liabilities are omitted in compilation of financial statement.

iii) Relevant Accounting Standards & Statutory Provisions have been complied with.

iv) Financial information have been classified and properly disclosed according to their nature.

Ans.2 (b) Areas in Which Differing Accounting Policies are Encountered

As per Accounting Standard 1, Disclosure of Accounting Policies, the following are examples of the areas in which different accounting policies may be adopted by different enterprises.

* Methods of depreciation, depletion and amortisation
* Treatment of expenditure during construction
* Conversion or translation of foreign currency items
* Valuation of inventories
* Treatment of goodwill
* Valuation of investments
* Treatment of retirement benefits
* Recognition of profit on long-term contracts
* Valuation of fixed assets
* Treatment of contingent liabilities

Disclosure of Accounting Policies

* 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 as such in one place instead of being scattered over several statements, schedules and notes.

* Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements 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 no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.
* Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Ans.3 (a) Following are the duties of CAG in conducting government audit :

1. To compile and submit accounts: The C & AG shall compile the accounts relating to the annual receipts and disbursements of the Union / State / Union Territory. He shall submit those accounts to the President / Governor / Administrator.

2. To render assistance in accounts maintenance: The C & AG shall give to the Union / Slate / Union Territory, such information as they may, from time to time, require and render such assistance in the preparation of the annual financial statements as they reasonably ask for.

3. To audit and report: The C&AG shall audit and report on:

(a) All expenditure from the Consolidated Fund of India/State/Union Territory and to ascertain whether the expenditure is in accordance with law and applicable to the service or purpose to which they have been charged.

(b) All transactions of the Union/State relating to Contingency Funds and Public Accounts;

(c) All trading, manufacturing. Profit and Loss Accounts and Balance Sheets and other subsidiary accounts kept in any department of the Union/State.

4. To audit Receipts & Expenditure: The C&AG shall audit & report on all receipts & expenditure of any body or authority, which has been substantially financed from the Consolidated Fund of India/State/Union Territory. For this purpose, a body or authority shall be treated as substantially financed if the amount of grant or loan in a year is (a) greater than Rs.25 lakhs & (b) such amount is more than 75% of the total expenditure of that body or authority.

5. To audit Grants or Loans: This applies to any specific purpose loan or grant, given from the Consolidated Fund of India / State / Union Territory, to any body other than a foreign State or international organisation. The C&AG shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions of giving such grants or loans.

6. To audit Receipts of Union or States: The C&AG shall audit all receipts payable into the Consolidated Fund of India / State / Union Territory. He shall satisfy himself that the rules and procedures are designed to secure an effective control on the assessment, collection and proper allocation of revenue.

7. To audit Accounts of Stores and Stock: The C&AG shall audit and report on the accounts of stores and stock kept in any office or department of the Union / State.

8. To audit accounts of Government Companies and Corporations: The C&AG shall have such powers and duties as provided in the Companies Act, 1956, in relation to Government Companies and Corporations.

Ans.3 (b) Basic Elements of the Auditor’s Report

The auditor’s report includes the following basic elements, ordinarily, in the following layout:

(a) Title;

(b) Addressee;

(c) Opening or introductory paragraph

- (i) identification of the financial statements audited;
- (ii) a statement of the responsibility of the entity’s management and the responsibility of the auditor;

(d) Scope paragraph (describing the nature of an audit)

- (i) a reference to the auditing standards generally accepted in India;
- (ii) a description of the work performed by the auditor;

(e) Opinion paragraph containing

- (i) a reference to the financial reporting framework used to prepare the financial statements; and
- (ii) an expression of opinion on the financial statements;

(f) Date of the report;

(g) Place of signature; and

(h) Auditor’s signature.

Ans.4 (a) As given in SA 505, External Confirmations, the design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses. Factors to be considered when designing confirmation requests include:

- The assertions being addressed.
- Specific identified risks of material misstatement, including fraud risks.
- The layout and presentation of the confirmation request.
- Prior experience on the audit or similar engagements.
- The method of communication (for example, in paper form, or by electronic or other medium).
- Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

Ans.4 (b) To understand auditing in its correct perspective, one should know how auditing is distinct from investigation. Auditing is different from investigation which is another significant service, a professional accountant renders. Investigation is a critical examination of the accounts with a special purpose. For example if fraud is suspected and an accountant is called upon to check the accounts to whether fraud really exists and if so, the amount involved, the character of the enquiry changes into investigation. Investigation may be undertaken in numerous areas of accounts, e.g., the extent of waste and loss, profitability, cost of production, etc. It normally concerns only specified areas, but at times, it may involve the whole field of accounting. Its essence lies in going into the matter with some pre-conceived notion suited to the objective. The techniques fit the circumstances of the case. For auditing on the other hand, the general objective is to find out whether the accounts show a true and fair view.

Audit never undertakes discovery of specific happenings and is never started with a pre-conceived notion about the state of affairs. The auditor seeks to report what he finds in the normal course of examination of the accounts adopting generally followed techniques unless circumstances call for a special probe: fraud, error, irregularity, whatever comes to the auditor's notice in the usual course of checking, are all looked into in depth and sometimes investigation results from the prima facie findings of the auditor.

Ans.5 (a) Audit of Hospital

The special steps involved in such an audit are stated below ;

(1) 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.

(2) 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.

(3) 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.

(4) Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.

(5) 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).

(6) 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.

(7) Verify that grants, if any, received from Government or local authority have been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.

(8) 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.

(9) Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Stock Register and that issues have been made only against proper authorisation.

(10) See that depreciation has been written off against all the assets at the appropriate rates.

Ans.5 (b) VERIFICATION OF SHARES ISSUED FOR CASH

Usually, there are three stages in the issue of shares for cash, viz. :

(i) Receipt of applications for shares along with application money;

(ii) Allotment of shares and receipt of allotment; and

(iii) Making calls and receipt of call money.

(1) Applications -

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

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

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

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

(2) Allotment -

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

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

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

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

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

Ans.6 (a) Audit Working Papers

The audit working papers constitute the link between the auditor's report and the client's records. Documentation is one of the basic principles listed in SA 200. According to 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). The objects of an auditor's working papers are to record and demonstrate the audit work from one year to another. Therefore, working papers should provide for :

(a) means of controlling current audit work;

(b) evidence of audit work performed;

(c) schedules supporting or additional item in the accounts; and

(d) information about the business being audited, including the recent history.

The current file normally includes :

* Correspondence relating to acceptance of annual reappointment.
* Extracts of important matters in the minutes of Board Meetings and General Meetings.
* Evidence of the planning process of the audit and audit programme.
* Analysis of transactions and balances.
* A record of the nature, timing and extent of auditing procedures performed, and the results of such procedures.
* Evidence that the work performed by assistants was supervised and reviewed.
* Copies of communication with other auditors, experts and other third parties.
* Letters of representation or confirmation received from the client.
* Conclusions reached by the auditor concerning significant aspects of the audit, including the manner in which exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated.
* Copies of the financial information being reported on and the related audit reports.

Ans.6 (b) Vouching of Travelling Expenses

Travelling expenses are normally payable to staff according to rules approved by directors or partners. Where no rules exist, the auditor should recommend that these be framed for controlling the expenditure. In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred. A voucher should be demanded for all items of expenses incurred, except those which are capable of independent verification. As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business and that the directors were entitled to receive the amount from the business.

The voucher for travelling expenses should normally contain the under mentioned information:

(i) Name and designation of the person claiming the amount.

(ii) Particulars of the journey.

(iii) Amount of railway or air fare.

(iv) Amount of boarding or lodging expenses or daily allowance along with the dates and times of arrival and departure from each station.

(v) Other expenses claimed, e.g., porter age, tips, conveyance, etc.

If the journey was undertaken by air, the counterfoil of the air ticket should be attached to the voucher; this should be inspected. For travel by rail or road, the amount of the fare claimed should be checked from some independent source. Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified. The evidence in regard to sundry expenses claimed is generally not attached to T.A. bills. So long as the amount appears to be reasonable it is usually not questioned. All vouchers for travelling expenses should be authorised by some responsible official. In the case of foreign travel or any extraordinary travel, the expenses, before being paid, should be sanctioned by the Board.

The travelling advance taken, if any should be settled on receipt of final bills. At the year, the amount not settled should be shown appropriately in the Balance Sheet. Unless the articles specifically provide or their payment has been authorised by a resolution of shareholders, directors are not entitled to charge travelling expenses for attending Board Meetings.

Ans.7 (a) Discounted Bills Receivable Dishonoured

(a) Obtain the schedule of discounted bills receivable dishonoured.

(b) Check the entry in bank statement regarding the amount of bills dishonoured and see that the bank has debited the account of client.

(c) Verify the bills receivable returned by the bank alongwith bank’s advice.

(d) See that the dishonoured bills have been noted and protested by following the proper procedure and the account of the drawee or the debtor is also debited.

(e) Check that bank commission, if any, charged by the bank has been recovered from the party.

Ans.7 (b) AUDITOR’S LIEN

- In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property.
- On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non payment of fees, for work done on the books and documents.
- The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:
  - Documents retained must belong to the client who owes the money.
  - Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
  - The auditor can retain the documents only if he has done work on the documents assigned to him.
  - Such of the documents can be retained which are connected with the work on which fees have not been paid.
- Under section 209 of the Act, books of account of a company must be kept at the registered office. But where Board has passed a resolution and a notice thereof has been sent to ROC, books of account could be kept at a different place.
- These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents.
- Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints.
- His working papers being his own property, the question of lien, on them does not arise.

Ans.7 (c) As per SA 200 Overall Objectives of the independent auditor and the conduct of an audit in accordance with standards on auditing, the risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.

Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterised by a large number of business failures.

Ans.7 (d) Cut-Off Arrangement

Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separate from those in the ensuing period so that the results of the working of each period can be correctly ascertained. The arrangement that is made for the purpose is technically known as "Cut-off arrangement". It essentially forms part of the internal check of the organisation. Accounts, other than sales, purchases and stock are not usually affected by the continuity of the business and, therefore, this arrangement is generally applied only to the aforesaid accounts. The auditor satisfies by examination and test checks that the cut-off procedures adequately ensure that:

(i) goods purchased, property in which has passed to the client, have in fact been included in the inventories and that the liability has been provided for in case of credit purchase; and

(ii) goods sold have been excluded from the inventories and credit has been taken for the sales; if the value of sales is to be received, the concerned party has been debited. The auditor may examine a sample of documents evidencing the movement of stocks into and out of stores, including documents pertaining to period shortly before and after the cut off date and check whether stocks represented by those documents were included or excluded as appropriate during stock taking.

Ans.7(e) Examination in Depth

It implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction, i.e., from initiation to the completion of the transaction by receipt of payment of cash and delivery or receipt of the goods. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure. For example, if payment to a creditor is to be verified "in depth", it would be necessary to examine the following documents:

(a) The invoice and statement of account received from the supplier.

(b) The entry in the stock record showing that the goods were received.

(c) The Goods Received Note and Inspection Certificate showing that the goods on receipt were verified and inspected.

(d) The copy of the original order and authority showing that the goods in fact were ordered by an authority which was competent to do so.

It is to be emphasised that, so far as the management is concerned, the internal control should have willing acceptance at the hands of the employees and there should exist proper mechanism for such motivation.