PAPER – 6: AUDITING AND ASSURANCE

PART – I: ACADEMIC UPDATE
(Legislative Amendments as per the Companies Act, 2013)

Companies (Cost Records and Audit) Rules, 2014: The Central Government has notified the Companies (cost records and audit) Rules, 2014, dated 30th June, 2014, which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

Rule 3 of the Companies (cost records and audit) Rules, 2014 provides the classes of companies required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act. Some of the companies prescribed under the rule are given below:

(A) Companies engaged in the production of following goods in strategic sectors, such as machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items; turbo jets and turbo propellers; arms and ammunitions.

(B) Companies engaged in an industry regulated by a Sectoral Regulator or a Ministry or Department of Central Government, such as aeronautical services of air traffic management, aircraft operations; telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997.

(C) Companies operating in areas involving public interest, such as mineral products including cement; ores; Construction Industry; companies engaged in health services viz. functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories.

(D) Companies (including foreign companies other than those having only liaison offices) engaged in the production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent).

As per Rule 5 of the Companies (cost records and audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, is required to maintain cost records in Form CRA-1. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Rule 6 of the Companies (cost records and audit) Rules, 2014 requires the companies prescribed under the said Rules to appoint an Auditor within one hundred and eighty days of the commencement of every financial year. Every referred company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

The cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

The cost auditor shall submit the cost audit report along with his reservations or qualifications or observations or suggestions, if any, in Form CRA-3. He shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

Duty to report on fraud: The provisions of sub-section (12) of section 143 of the Companies Act, 2013 and the relevant rules on duty to report on fraud shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

Cost Audit Rules not to apply in certain cases: The requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

(i) whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue; or

(ii) which is operating from a special economic zone.

Submission of Cost Audit Report: A company shall, within thirty days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government), furnish with the Central Government such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014. If, after considering the cost audit report referred to under this section and the, information and explanation furnished by the company as above, the Central Government is of the opinion, that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

PART – II: QUESTIONS AND ANSWERS

QUESTIONS

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

   (i) In case of failure of the Board to appoint the first auditor, it shall inform the Central Government.

   (ii) Where a person appointed as an auditor of a company incurs any of the disqualifications after his appointment, he will still continue as an auditor.

   (iii) An auditor appointed under the Companies Act, 2013 shall provide to the company only such other services as are approved by the company in general meeting.

   (iv) Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company kept at the registered office of the company only.

   (v) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

   (vi) As defined under Companies Act, 2013, “Book and paper” and “Book or paper” include books of account only.

   (vii) At every annual general meeting of a company, the Board of directors of the company shall lay before the company the financial statements for the financial year.

   (viii) “Issued Capital” means such capital as the company issues from time to time for subscription. It is that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.

   (ix) Standards on Review Engagements (SREs) - to be applied in the audit of historical financial information.

   (x) Narrative Record is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer.

Nature of Auditing

2. (a) Discuss the auditor’s responsibilities for detection of frauds and errors with specific reference to Standards on Auditing and Companies Act, 2013.

   (b) “The process of auditing is such that it suffers from certain limitations which cannot be overcome irrespective of the nature and extent of audit procedures.” Explain.

3. (a) “Audit is not legally obligatory for all types of business organisations or institutions” Discuss.

(b) "Having accounts audited by independent auditor, among other advantages, acts as a moral check on the employees from committing fraud." Explain stating the advantages of Independent audit.

4. (a) "Auditor is expected to be familiar with the overall economic environment in which his client is operating." Discuss.

(b) Discuss the procedure to be followed by the auditor in case he has sufficient reason to believe that an offence involving fraud has been committed against the company by its officers.

Basic Concepts in Auditing

5. "Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated." Discuss.

6. (a) "Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements whereas for some accounting estimates there may be relatively high estimation uncertainty particularly where they are based on significant assumptions". Explain by giving examples.

(b) Explain what do you mean by Analytical procedures. How such procedures are helpful in auditing?

7. (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) The audit working papers constitute the link between the auditor's report and the client's records. Discuss stating clearly the objectives of audit working papers.

Preparation for an Audit

8. (a) What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of the SA 530.

(b) What precautions should be taken by an auditor while applying test check techniques?

9. (a) "An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so." Discuss.

(b) For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. Describe some of the techniques commonly adopted by the auditors.

Internal Control

10. (a) Your firm of Chartered Accountants has been allotted Information Systems Audit of 6 branches of Oriental Bank of Commerce. How would you assess the reliability of internal control system in computerised information system?

    (b) “Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved.” Explain.

11. (a) GR & Co., a firm of Chartered Accountants has been called upon to audit the accounts of Dee Vee Philips Ltd. The auditors are told that Company is not performing well due to weak accounting and administration system in place. Mr. Preet handling the assignment noticed that there are gaps in internal check system of the company. You are required to explain the special steps involved in framing a system of Internal Check.

    (b) “The purpose of EDP application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorised and recorded, and are processed completely, accurately and on a timely basis.” Discuss.

Vouching & Verification of Assets and Liabilities

12. (a) Explain clearly the meaning of vouching. Also discuss the points that should be considered while examining a voucher.

    (b) Discuss the important points that you would look into while carrying scrutiny of General Ledger.

13. How will you verify/vouch the following:

    (a) Contingent Liabilities

    (b) Excise Duty

    (c) Recovery of Bad-debts written off

    (d) Endowment Policies.

14. Explain the factors to be considered while "Vouching of travelling expenses".

The Company Audit

15. (a) Discuss the provisions contained in the Companies Act, 2013 regarding appointment of First Auditors in the case of Government Company.

    (b) “Provisions regarding rotation of auditors affect only specific class of companies”. Discuss.

16. (a) State the disclosure required to be made in the financial statements if these do not comply with the accounting standards.

(b) "A portion of Share Premium utilised to declare 40% dividend." Comment.

17. (a) Explain the Director's responsibility statement in brief.

(b) Breifly discuss the provisions of the Companies Act, 2013 with regard to issue of shares at a discount.

(c) A vacancy arose in the office of an auditor of XYZ Ltd due to death of the Auditor Mr Z and the Managing Director of the company filled that vacancy. Comment citing the provisions of the Companies Act, 2013.

18. (a) An auditor purchased goods worth ₹ 501,500 on credit from a company being audited by him. The company allowed him one month's credit, which it normally allowed to all known customers. Comment.

(b) An auditor became aware of a matter regarding a company only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion. Comment.

Special Audits

19. (a) What role is played by Comptroller and Auditor General of India in the audit of a Government company?

(b) "Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG." Discuss.

20. Mention any ten special points to be examined by you in the audit of Income and Expenditure of a Charitable Institution running a hospital.

SUGGESTED ANSWERS / HINTS

1. (i) **Incorrect** : According to section 139(6) of the Companies Act, 2013, in the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

(ii) **Incorrect:** Where a person appointed as an auditor of a company incurs any of the disqualifications after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

(iii) **Incorrect:** According to section 144 of the Companies Act, 2013, an auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee.

(iv) **Incorrect:** As per Section 143(1) of the Companies Act, 2013, every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company kept not only at the registered office of the company but also at any other place too.

(v) **Correct:** As per Section 139(10) of the Companies Act, 2013, where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

(vi) **Incorrect:** As per section 2(12) of the Companies Act, 2013, "Book and paper" and "Book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.

(vii) **Correct:** As per Section 129(2), at every annual general meeting of a company, It shall be the duty of the Board of Directors of the company to lay before the company the financial statements for the financial year.

(viii) **Correct:** Section 2(50) of the Companies Act, 2013 defines "issued capital" which means such capital as the company issues from time to time for subscription; It is that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.

(ix) **Incorrect:** Standards on Review Engagements (SREs) - to be applied in the review of historical financial information.

(x) **Incorrect:** Narrative Record is a complete and exhaustive description of the system as found in operation by the auditor. On the other hand, a Check List is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer.

2. (a) **Auditor's Responsibilities for Detection of Fraud and Error**: As per SA 240 "The Auditor's Responsibilities relating to fraud in an audit of Financial Statements", an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false.

When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

An audit conducted in accordance with the auditing standards generally accepted in India is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The fact that an audit is carried out may act as a deterrent, but the auditor is not and cannot be held responsible for the prevention of fraud and error.

The auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance; hence, in an audit, the auditor does not guarantee that material misstatements, whether from fraud or error, will be detected. Therefore, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not, in and of itself, indicate:

(i) failure to obtain reasonable assurance,

(ii) inadequate planning, performance or judgment,

(iii) absence of professional competence and due care, or,

(iv) failure to comply with auditing standards generally accepted in India.

In planning and performing his examination the auditor should take into consideration the risk of material misstatement of the financial information caused by fraud or error. He should inquire with the management as to any fraud or significant error, which has occurred in the reporting period, and modify his audit procedures, if necessary. If circumstances indicate the possible existence of fraud and error, the auditor should consider the potential effect of the suspected fraud and error on the financial information. If he is unable to obtain evidence to confirm, he should consider the relevant laws and regulations before expressing his opinion.

The auditor also has the responsibility to communicate the misstatement to the appropriate level of management on a timely basis and consider the need to report to it then changed with governance. He may also obtain legal advice before reporting on the financial information or before withdrawing from the engagement. The auditor should satisfy himself that the effect of fraud is properly reflected in the financial information or the error is corrected in case the modified procedures performed by the auditor confirm the existence of the fraud.

The auditor should also consider the implications of the frauds and errors, and frame his report appropriately. In case of a fraud, the same should be disclosed in the financial statement. If adequate disclosure is not made, there should be a suitable disclosure in his audit report.

Further, as per sub section 12 of section 143 of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.

(b) **Inherent limitations of Audit**: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on

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

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

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

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

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

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

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

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

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

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

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

The organisations which require audit under law are the following:

(i) Companies governed by the Companies Act;

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

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

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

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

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

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

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

(b) Advantages of Independent Audit: 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.

4. (a) Auditing and Economics: As, it is well known, accounting is concerned with the accumulation and presentation of data relating to economic activity. Though the concept of income as put forward by economists is different as compared to the accountants concept of income, still, there are lot of similar grounds on which the accounting has flourished. From the auditing view point, the auditors are more concerned with Micro economics rather than with the Macro economics. The knowledge of Macro economics should include the nature of economic force that affect the firm, relationship of price, productivity and the role of Government and Government regulations. Auditor is expected to be familiar with the overall economic environment in which his client is operating.

(b) Procedure to be Followed in case of Fraud: Rules 13 of the Companies (Audit and Auditors) Rules, 2014, prescribes that in case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days of his knowledge and after following the procedure indicated herein below:

(i) auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within forty-five days;

(ii) on receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee alongwith his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days of receipt of such reply or observations;

(iii) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government alongwith a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.

5. 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.

6. (a) Accounting Estimates: Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- ➢ Accounting estimates arising in entities that engage in business activities that are not complex.
- ➢ Accounting estimates that are frequently made and updated because they relate to routine transactions.

For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- ➢ Accounting estimates relating to the outcome of litigation.
- ➢ Fair value accounting estimates for derivative financial instruments not publicly traded.

Additional examples of accounting estimates are:

- ➢ Allowance for doubtful accounts.
- ➢ Inventory obsolescence.

- Warranty obligations.
- Depreciation method or asset useful life.
- Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
- Outcome of long term contracts.
- Financial Obligations / Costs arising from litigation settlements and judgments.

(b) **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:

(i) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and

(ii) 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.

7. (a) **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) **Audit Working Papers:** The audit working papers constitute the link between the auditor's report and the client's records. SA 230 on "Audit Documentation" states that Audit Working papers are the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. The object of Audit working papers is to provide:

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

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

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

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

Working papers should contain audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained. The auditor shall assemble the audit working papers in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. The retention period for audit working papers ordinarily is no shorter than ten years from the date of the auditor's report, or, if later, the date of the group auditor's report. Unless otherwise specified by law or regulation, audit working papers are the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients.

8. (a) **Audit Sampling:** "Audit Sampling" means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

There are many methods of selecting samples. The principal methods are as follows:

(i) Random selection (applied through random number generators, for example, random number tables). Stratified Sampling is one of the methods of Random Sampling. This method involves dividing the whole population to be tested in a few groups called strata and taking a sample from each of them. Each stratum is treated as if it were a separate population and if proportionate items are selected from each of the stratum. The groups into which the whole population is divided is determined by the auditor on the basis of his judgement e.g. entire expense vouchers may be divided into:

(1) Vouchers above ₹ 1,00,000

(2) Vouchers between ₹ 25,000 and ₹ 1,00,000

(3) Vouchers below ₹ 25,000

The auditor can then decide to check all vouchers above ₹ 1,00,000, 50% between ₹ 25,000 and ₹ 1,00,000 and 25% of those below ₹ 25,000.

The reasoning behind the stratified sampling is that for a highly diversified population, weights should be allocated to reflect these differences. This is achieved by selecting different proportions from each strata. It can be seen that the stratified sampling is simply an extension of simple random sampling.

(ii) Systematic selection, in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerised random number generator or random number tables. When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.

(iii) Monetary Unit Sampling is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

(iv) Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

(v) Block selection involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

(b) Test Check Technique: 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) Acceptance of a Change in Engagement: An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to:

(i) the original engagement; or

(ii) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

(i) Withdraw from the audit engagement where possible under applicable law or regulation; and

(ii) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

(b) Audit Techniques: For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. Some of the techniques commonly adopted by the auditors are the following:

(i) Posting checking

(ii) Casting checking

(iii) Physical examination and count

(iv) Confirmation

(v) Inquiry

(vi) Year-end scrutiny

(vii) Re-computation

(viii) Tracing in subsequent period

(ix) Bank Reconciliation

It may be noted that the two terms, procedure and techniques, are often used inter-changeably; in fact, however, a distinction does exist. Procedure may comprise a number of techniques and represents the broad frame of the manner of handling the audit work; techniques stand for the methods employed for carrying out the procedure. For example, procedure requires an examination of the documentary evidence. This job is performed by the procedure known as vouching which would involve techniques of inspection and checking computation of documentary evidence.

10. (a) Reliability of Internal Control System in CIS: For evaluating the reliability of internal control system in CIS, the auditor would consider the followings:-

(i) That authorised, correct and complete data is made available for processing.

(ii) That it provides for timely detection and corrections of errors.

(iii) That in case of interruption due to mechanical, power or processing failures, the system restarts without distorting the completion of entries and records.

(iv) That it ensures the accuracy and completeness of output.

(v) That it provides security to application softwares & data files against fraud etc.

(vi) That it prevents unauthorised amendments to programs.

(b) Limitations of Internal Control system: Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as:-

(i) Management's consideration that cost of an internal control does not exceeds the expected benefits.

(ii) Most controls do not tend to be directed at unusual transactions.

(iii) The potential of human error due to carelessness, misjudgment and misunderstanding of instructions.

(iv) The possibility that control may be circumvented through collusion with employees or outsiders.

(v) The possibility that a person responsible for exercising control may abuse that authority.

(vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.

(vii) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

(viii) Inherent limitations of Audit.

11. (a) General Considerations in Framing a System of Internal Check: The term "internal check" is defined as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is

proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". The following aspects should be considered in framing a system of internal check:

(i) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.

(ii) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.

(iii) Every member of the staff should be encouraged to go on leave at least once in a year so that frauds successfully concealed by such a person can be detected in his absence.

(iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.

(v) There should be an accounting control in respect of each important class of assets, in addition, these should be periodically inspected so as to establish their physical condition.

(vi) The system of Budgetary Control should be introduced.

(vii) For inventory-taking, at the close of the year, trading activities should, if possible, be suspended. The task of inventory-taking, and evaluation should be done by staff belonging to other than inventory section.

(viii) The financial and administrative powers should be sub divided very judicially and the effect of such division should be reviewed periodically.

(ix) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.

(b) EDP Application Controls: The purpose of EDP application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorised and recorded, and are processed completely, accurately and on a timely basis. These include:

(1) *Controls over input are designed to provide reasonable assurance that:*

(i) Transactions are properly authorised before being processed by the computer.

(ii) Transactions are accurately converted into machine readable form and recorded in the computer data files.

(iii) Transactions are not lost, added, duplicated or improperly changed.

(iv) Incorrect transactions are rejected, corrected and if necessary, resubmitted on a timely basis.

(2) *Controls over processing and computer data files are designed to provide reasonable assurance that:*

(i) Transactions, including system generated transactions, are properly processed by the computer.

(ii) Transactions are not lost, added, duplicated or improperly changed.

(iii) Processing errors are identified and corrected on a timely basis.

(3) *Controls over output are designed to provide reasonable assurance that:*

(i) Results of processing are accurate.

(ii) Access to output is restricted to authorised personnel.

(iii) Output is provided to appropriate authorised personnel on a timely basis.

12. (a) Vouching: The act of examining vouchers is referred to as vouching. It is the practice followed in an audit, with the objective of establishing the authenticity of the transaction recorded in the primary books of account. It essentially consists of verifying a transaction recorded in the books of account with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mentioned in the voucher has been posted to an appropriate account which would disclose the nature of transaction on its inclusion in the final statements of account. After examination, each voucher is marked in a manner to ensure that it may not be presented again in support of another entry. The following points need careful consideration while examining a voucher:

(i) that the date of the voucher falls within the accounting period;

(ii) that the voucher is made out in the client's name;

(iii) that the voucher is duly authorised;

(iv) that the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and

(v) that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

(b) Scrutiny of General Ledger:

(i) The General Ledger contains all the balances which are ultimately included in the Profit and Loss Account and the Balance Sheet. Its examination therefore is undertaken last of all.

(ii) The scrutiny of General Ledger should be carried out with due care in as much as it is the final review of balances which, on inclusion in Final Accounts, cumulatively reflect the financial position of the concern.

(iii) Entries in the General Ledger usually are posted in a summary form from the books of original entries such as Cash Book, Journal, Sales Book, Purchase Book and other subsidiary books. Therefore, it should be confirmed that all the postings on various accounts have been verified, totals, etc. checked.

(iv) It should also be ascertained that balances in all the income and expense accounts have been adjusted: (1) according to standard accounting practices (i.e., all unpaid, prepaid expenses have been adjusted and accrued Income and pre-recorded income is properly adjusted); and (2) on a consideration of the legal provisions which are applicable to the concern.

(v) The balances in the General Ledger should be traced to the trial balance and from the trial balance to the final accounts.

13. (a) **Contingent liabilities:** Accounting Standard (AS) 29 on 'Provisions, Contingent Liabilities and Contingent Assets', defines 'Contingent Liability' as a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or as a present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a reliable estimate of the amount of the obligation cannot be made.

The auditor may take following steps to vouch or verify the contingent liabilities:

(i) Inspect the minute books of the company to ascertain all contingent liabilities known to the company.

(ii) Examine the contracts entered into by the company and the likelihood of contingent liabilities emanating therefrom.

(iii) Scrutinise the lawyer's bills to track unreported contingent liabilities.

(iv) Examine bank letters in respect of bills discounted and not matured.

(v) Examine bank letters to ascertain guarantees on behalf of other companies or individuals.

(vi) Discuss with various functional officers of the company about the possibility of contingent liability existing in their respective field.

(vii) Obtain a certificate from the management that all known contingent liabilities have been included in the accounts and they have been properly disclosed.

(viii) Ensure that proper disclosure has been made as per Schedule III to the Companies Act, 2013 and AS 29, "Provisions, Contingent Liabilities and Contingent Assets".

(b) Excise Duty: Excise duty is levied on manufacture. The liability for duty arises only at the point of time at which manufacturing is complete. The point of time at which duty is collected may be determined by consideration of administrative convenience. Normally excise duty is paid before the issue of excisable goods from the factory. For this, the auditor should take into consideration:

(i) Ensure that excise duty is paid at the time of issue of excisable goods from the godown at factory of the producer. The duplicate copy of the challan as issued by the bank is forwarded for the purpose of issue of the excisable goods.

(ii) Verify the amount of duty paid with the corresponding value of the goods issued from the inventory register of the producer by applying test check. In case where the client maintains an advance deposit with Excise Department, the auditor should see that the permits are issued for delivery of the goods against the advance deposit and corresponding adjustment.

(iii) Ascertain the rates of excise duty and apply it to the total sales and see that the amount actually paid does not exceed the amount thus calculated.

(iv) Ascertain that in case of dispute about the amount of duty payable, a provisional amount may be paid in lieu of final amount. In such cases, the final amount determined as payable should be verified. If the provisional payment was more than the actual amount, the refund of such excess amount should be vouched.

(v) The auditor may also physically verify RG 1 with actual and see reconciliation of financial records with sales tax records.

(c) Recovery of Bad Debts written off:

(i) Check all correspondence and proper authorization of bad debts written off earlier and ensure that the decision of writing off of bad debts was recorded properly.

(ii) Ascertain total bad debts and see whether all recovery of bad debts is recorded properly in the books of account and deposited into bank.

(iii) Check all notifications from Court or bankruptcy trustee and all correspondence from trade receivables and collecting agencies.

(iv) Check Credit Manager's files for amount recovered and confirm acknowledgement receipts issued to trustee/trade receivables.

(d) Endowment Policies:

(i) Ascertain the specific purpose for which the endowment policy is taken, e.g., Sinking Fund policies for redemption of debentures, redemption of leases or policies taken for other similar purposes, etc.

(ii) Verify the terms and conditions of policies and ensure that all such conditions are in force and being followed.

(iii) Check that premium has been deposited in time and the policy is in force.

(iv) Examine that proper disclosures have been made in the financial statements in respect of items for which the policy has been taken.

14. Vouching of Travelling Expenses: The following factors are to be considered while "Vouching of Travelling Expenses":

(i) 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.

(ii) 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.

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

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

(2) Particulars of the journey.

(3) Amount of railway or air fare.

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

(5) Other expenses claimed

(iv) 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.

(v) Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified.

(vi) 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.

(vii) The travelling advance taken, if any, should be settled on receipt of final bills. At the year end, the amount not settled should be shown appropriately in the Balance Sheet.

(viii) 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.

15. (a) Appointment of First Auditors in the case of Government Company: Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

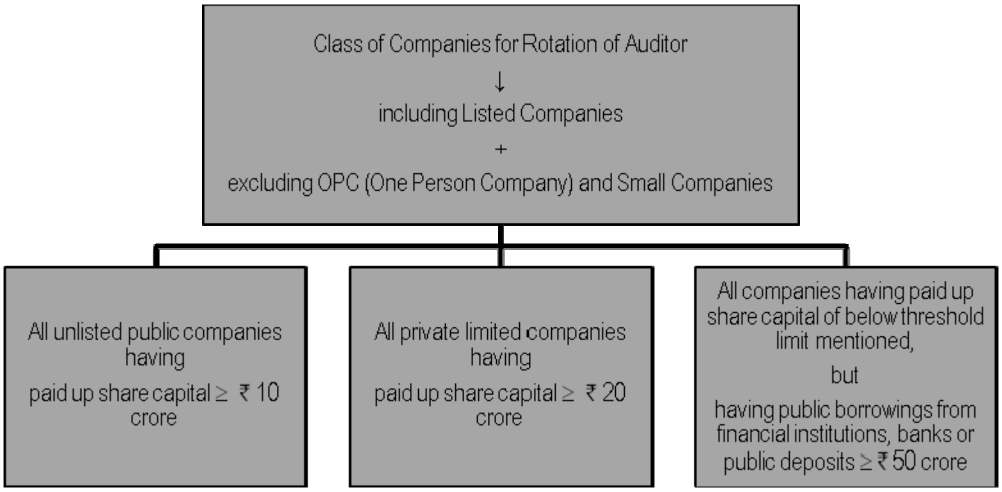
(b) Applicability of provisions related to Rotation of Auditors: The provisions related to rotation of auditor as provided under section 139(2) of the Companies Act, 2013 are applicable to all listed companies and other class or classes of companies as prescribed under Companies (Audit and Auditors) Rules, 2014.

As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies excluding one person companies and small companies:-

(I) all unlisted public companies having paid up share capital of rupees ten crore or more;

(II) all private limited companies having paid up share capital of rupees twenty crore or more;

(III) all companies having paid up share capital of below threshold limit mentioned in (I) and (II) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.



16. (a) **Deviations from Accounting Standards:** According to Section 129(5) of the Companies Act, 2013, if the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements the following namely:

    (i) the deviation from the accounting standards,

    (ii) the reasons for such deviation and

    (iii) the financial effects, if any, arising out of such deviation.

    (b) **Utilisation of Share Premium:** Section 52 of the Companies Act, 2013 deals with application of premium received on issues of shares. Section 52(1) requires creation of Securities Premium Account and states that the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the premium account were paid-up share capital of the company. Section 52(2) lays down that the securities premium account may be applied by the company:

    (i) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

    (ii) in writing off the preliminary expenses of the company;

    (iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

    (iv) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

    (v) for the purchase of its own shares or other securities under Section 68.

Thus, it is clear from the above that share premium can be utilised only for specific purposes. Further, section 123 of the Companies Act, 2013 also specifies the sources from which dividends can be paid and requires the same to be only paid out of past profits, general reserve or any other free reserve. Hence, declaration of dividends out of share premium is not proper and, consequently, the auditor shall have to qualify the audit report.

17. (a) Director's Responsibility statement: The provisions related to Director's Responsibility Statement are provided under section 134(5) of the Companies Act, 2013. According to it, the report of board of directors on annual accounts shall also include a 'Director's Responsibility Statement' indicating therein:

(i) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(ii) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(iii) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(iv) the directors had prepared the annual accounts on a going concern basis; and

(v) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation – For the purposes of this clause, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

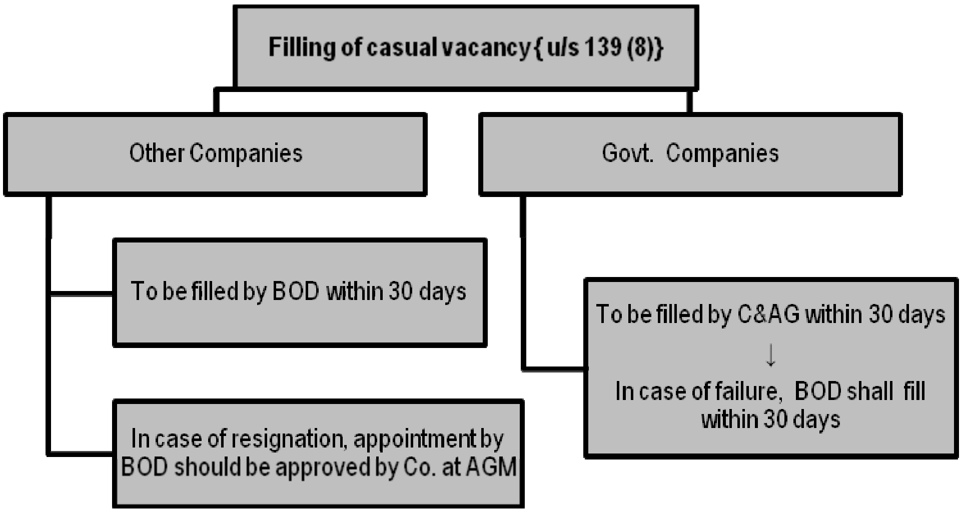
(vi) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

(b) Issue of Shares at a Discount: According to Section 53 of the Companies Act, 2013, except sweat equity shares issued as mentioned in section 54, any share issued by a company at a discounted price shall be void.

Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

(c) Filling of Casual Vacancy: Section 139(8) of the Companies Act, 2013 states that any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within thirty days. But if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

In the given case, vacancy in the office of an auditor has arisen because of death and not due to resignation, therefore applying the above provisions it would be filled by the Board of Directors within thirty days. Appointment made by the Managing Director of the Company is not valid.



18. (a) Purchase of goods on credit by the auditor: Section 141(3)(d)(ii) of the Companies Act, 2013 read with Companies (Audit and Auditors) Rules, 2014 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for an amount exceeding five lakh rupees.

Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds rupees five lakh, he is disqualified for appointment as an auditor of the company.

Further, as per section 141(4) of the said Act, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

It will not make any difference if the company allows him the same period of credit as it allows to other customers on the normal terms and conditions of the business. The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers.

Therefore, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office.

(b) **Audit Opinion:** Section 146 of the Companies Act, 2013 empowers the auditors of a company to attend any general meeting of the company; to receive all the notices and other communications relating to the general meeting, unless otherwise exempted by the company, and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Where the auditor has reason to believe that the directors concealed deliberately a serious fact from the shareholders which came to his note after issuance of the audit report, he should exercise this right. Normally speaking, an auditor considers subsequent events only upto the date of issuance of the audit report.

The discovery of a fact after issuance of the financial statements that existed at the date of the audit report which would have caused the revision of the audit report, requires the auditor to bring this to the notice of shareholders.

Likewise, it may be advisable for the auditor to attend the meeting with a view to bringing to the notice of the shareholders any matter which came to his knowledge subsequent to his signing the report and if it had been known to him at the time of writing his audit report, he would have drawn up the report differently; or where the accounts have been altered after the report was attached to the accounts.

19. (a) **Role of C&AG in the Audit of a Government company :** Role of C&AG is prescribed under sub section (5), (6) and (7) of section 143 of the Companies Act, 2013.

In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of

India, the action taken thereon and its impact on the accounts and financial statement of the company.

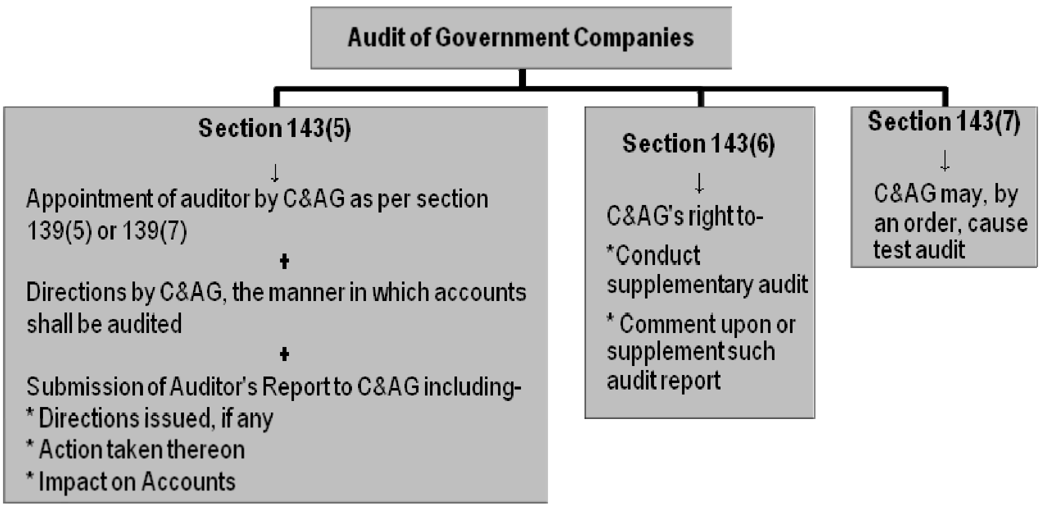
The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to,

(i) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

(ii) comment upon or supplement such audit report:

It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Test Audit : Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.



(b) Audit of Stores and Inventories: Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out. The aim is also to bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control. The audit of purchase of stores is conducted in the same manner as audit of expenditure, namely, that these are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority. The auditor has to ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit. Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

20. Audit of Hospital: While auditing the Income and Expenditure Account of a charitable institution running a hospital, following special points may be examined:

(i) Verify the register of patients with duplicate copy of bills and patients admission record to see that bills have been properly and correctly prepared for all the services, tests and treatments.

(ii) Check cash collections from patients by tracing the receipt issued into cash book.

(iii) Check receipt of interest, rent, dividend etc., with receipt counterfoil into cash book and bank book and ensure that all such income has been duly accounted for.

(iv) Check collection of subscription, donations from the receipt issued, correspondence etc., into cash book.

(v) Verify that all grants from government and other bodies have been duly accounted for and have been applied in the manner as specified.

(vi) Verify all recurring nature of revenue expenditure, with necessary evidence like bill, authority, period etc.

(vii) Examine the internal check as regards the receipt and issue of stores, medicines, linen etc., to ensure that these have been properly recorded and issued/consumed only on proper authorisation.

(viii) See that depreciation has been written off in respect of all the assets at appropriate rate and method as in the earlier year.

(ix) Verify the receipts from supply of food and canteen receipts and compare the same with previous year as regards number of patients.

(x) Ensure that all outstanding liabilities have been adequately provided for and similarly all accrued incomes and receipts have been duly accounted for.

(xi) Obtain inventory of stock and stores as at the end of the year and physically check a percentage of items.