



## FINAL CA – NOV 2018

### SUB: AUDIT

Topics:

Test Code – CF 17

Branch

(50 Marks)

compulsory.

Note: All questions are

#### Question 1 (8 marks)

Audit Plan to locate the Abnormal Wastage of Raw Material: To locate the reasons for the abnormal wastage, the auditor should first of all assess the general requirements as under:		
(i) Procure a list of raw materials, showing the names and detailed characteristics of each raw material.		1/2
(ii) Obtain the standard consumption figures, and ascertain the basis according to which normal wastage figures have been worked out. Examine the break-up of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards		1/2
(iii) Examine the various records maintained for recording separately the various lots purchased and identification of each lot with actual material consumption and for ascertaining actual wastage figures therein.		1/2
(iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrappage work.		1/2
(v) Assess whether personnel employed are properly trained and working efficiently.		1/2
(vi) See whether quality control techniques have been consistent or have undergone any change		1/2
(vii) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.		1/2
(viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months		1/2
(ix) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.		1/2
In addition, some specific reasons for abnormal wastage in process may be considered by the auditor are as under:		
(i) Examine laboratory reports and inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.		1/2
(ii) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.		1/2
(iii) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors' reports in respect of inspection carried out on the completion of each stage of work or process.		1/2

(iv) It is possible that the wastage may have occurred because the particular lot out of which issues were made was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures		1/2
(v) Abnormal wastage in storage and handling may arise due to the following reasons: (1) Write offs on account of reconciliation of physical and book inventories: In case of periodical physical inventory taking, such write offs will be reflected only in the month such reconciliation takes place. (2) Accidental, theft or fire losses in storage: The auditor should examine the possibility of these for the purpose		1
(vi) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.		1/2

**Question 2 (5 marks)**

The term <u>“internal check”</u> is defined as the <u>“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”</u> . The following aspects should be considered in framing a system of internal check:		1/2
1. <u>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.</u>		1/2
2. <u>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.</u>		1/2
3. <u>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.</u>		1/2
4. <u>Persons having physical custody of assets must not be permitted to have access to the books of accounts.</u>		1/2
5. There should be an <u>accounting control</u> in respect of <u>each important class of assets</u> , in addition, these should be <u>periodically inspected so as to establish their physical condition.</u>		1/2
6. <u>The system of Budgetary Control should be introduced.</u>		1/2
7. For <u>stock-taking</u> , at the <u>close of the year</u> , trading activities should, if possible, be <u>suspended</u> . The task of <u>stock-taking</u> , and <u>evaluation</u> should be <u>done by staff belonging to other than stock section.</u>		1/2
8. The <u>financial and administrative powers</u> should be <u>sub divided very judiciously</u> and the <u>effect of such division</u> should be <u>reviewed periodically.</u>		1/2
9. Finally, the <u>system must be capable of being expanded or contracted to correspond to the size of the concern.</u>		1/2

**Question 3 (8 marks)**

<p><u>The review process for controls in a computerized information system (CIS) environment:</u> In a CIS environment there are different types of control which operate over data moving into, through and out of the computer. These are designed in such a way that the correct, complete and reliable processing and storage is ensured. It is necessary for the auditor to review such controls in order to get the correct result from the data entered. The review process can be laid down as follows:</p>		1
<p>(i) <u>Organisation structure and control:</u> The entity may have different functions under the CIS environment. There will be Data Administrator who will formulate data policies, plans the evaluation of the corporate data bases and maintain the data documentation. The data base administrator will be responsible for operational efficiency of the database, the system Analyst will manage the information requirements for new and existing applications, and designs the information system, the System programmer will maintain and enhance the Operating system software, application programmer will design the Programme to meet the information requirement, Operation Specialist plans and control day-to-day operations, monitors and improves operational efficiency along with capacity planning and Librarian maintains library of magnetic media and documentation. The auditor will see that the responsibilities of each job position are clear and that the person understands the duties, authority and responsibilities. The duties have to be separated to ensure the internal control is established</p>		3
<p>(ii) <u>Documentation Control:</u> The auditor has to see that there is proper and adequate documentation for approval of system flowcharts Programme flowcharts, Programme changes, operator's instructions and programme description and the changes made in the above are also documented and approved by the authorized persons.</p>		1/2
<p>(iii) <u>Access Control:</u> The auditor has to ensure the system prevents the persons who are authorized for access from accessing restricted data and programme and also prevents unauthorized persons gaining access to the system as a whole</p>		1/2
<p>(iv) <u>Input controls:</u> The control in respect of input has to be effective to ensure that only properly authorized and approved data goes in the input into the CIS system. For validation of input controls the auditor can apply some procedures like Check digit control, completeness totals control, reasonableness checks, field checks, record checks, file checks etc.</p>		1
<p>(v) <u>Processing controls:</u> These controls are must for integrity of data. Processing validation checks should be applied.</p>		1/2
<p>(vi) <u>Recording Controls:</u> This is for enabling the records to be kept free of errors.</p>		1/2
<p>(vii) <u>Storage Controls:</u> The data is the heart of the CIS system. Back up and recovery facilities will ensure the proper data availability to the management.</p>		1/2
<p>(viii) <u>Output controls:</u> The data processed must go to the authorized person in the manner it is required and for this purpose input controls are maintained. The auditor is interested to know whether the audit trail relating to output is provided.</p>		1/2

**Question 4 (4 marks)**

Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include:		
1. The <u>accuracy with which the expected results of substantive analytical procedures can be predicted</u> . For example, the <u>auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising</u> .		1
2. The <u>degree to which information can be disaggregated</u> . For example, <u>substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole</u> .		1
3. The <u>availability of the information, both financial and non-financial</u> . For example, the <u>auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures</u> . If the <u>information is available, the auditor may also consider the reliability of the information</u> .		2

**Question 5 (3 marks)**

1. As per <u>Section 139</u> , the members of a company may resolve to provide that - a. in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or b. the audit shall be conducted by more than one auditor.		2
2. Since the Board opines that the removal of auditors is a lengthy procedure, the members can opt for such a re-shuffle.		1

**Question 6 (7 marks)**

Under section 35 of the Companies Act, 2013 -		
1. Where a <u>person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—</u>		1/2
(a) is a <u>director of the company at the time of the issue of the prospectus;</u>		1/2
(b) has <u>authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;</u>		1/2
(c) is a <u>promoter of the company;</u>		1/2
(d) has <u>authorised the issue of the prospectus; and</u>		1/2

(e) is an <u>expert referred to in sub-section (5) of section 26, shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.</u>		1/2
2. <u>No person shall be liable under sub-section (1) above, if he proves—</u>		
(a) that, <u>having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent, or</u>		1/2
(b) that the <u>prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.</u>		1/2
3. <u>Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.</u>		1
Under <u>section 448, an auditor is liable for criminal prosecution, if he, in any return, certificate, balance sheet, prospectus, statement or other document required by or for the purpose of the Act, makes a statement</u>		1/2
(a) which is <u>false in any material particular knowing it to be false; or</u>		1/2
(b) which <u>omits any material fact knowing it to be material.</u>		1/2
<u>If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act.</u>		1/2

**Question 7 (4 marks)**

In the study of the systems and procedural functions, the auditor should ask himself:		
1. Is the <u>function properly located in the organisation?</u>		1
2. Do the <u>staff personnel have the necessary training and experience to perform the work?</u>		1
3. Has a <u>definite programme been established and has been taken for its attentive accomplishment?</u>		1
4. Is <u>productivity satisfactory?</u>		1

**Question 8 (4 marks)**

<u>Strict confidentiality shall be maintained by all those involved in the Peer Review process, namely, Reviewers, members of the Board, any Qualified Assistants or Practice Unit.</u>		1/2
---	--	-----

All persons governed by the secrecy provisions:		
(a) shall at all times <u>preserve and aid in preserving secrecy</u> with regard to any matter arising in the performance or in assisting in the performance of any function, directly or indirectly related to the process and conduct of Peer Reviews;		1
(b) Reviewer <u>shall not make use of or disclose the contents of Review report</u> or any confidential information about the process of Review unless as required by the Board or the Council.		1
<u>Non-compliance</u> with the secrecy provisions in the above clause shall amount to <u>professional misconduct</u> as defined under Section 22 of the Chartered Accountants Act, 1949.		1/2
A <u>Declaration of Confidentiality</u> shall be signed by the persons who are responsible for the conduct of Peer Review i.e., Reviewers, and his Qualified Assistants and be filed with the Board. All members of the Board shall also <u>sign a declaration of Confidentiality</u> in a manner as may be prescribed by the Board		1

#### Question 7 (7 marks)

1. When a <u>trade has been executed</u> , the <u>shares and money</u> should be transferred to the <u>respective parties on settlement date</u> .		1/2
2. When an <u>investor enters</u> into a <u>transaction with a broker, shares or funds</u> , as the case may be, are <u>delivered to the broker</u> . In turn, the <u>broker delivers</u> these on <u>settlement day to the settlement agent</u> .		1/2
3. In BSE, the settlement agent is known as ' <u>Clearing House (CH)</u> ' whereas in NSE it is ' <u>National Securities Clearing Corporation Ltd. (NSCCL)</u> '.		1
4. Movement of securities has <u>become almost instantaneous</u> in the <u>dematerialised environment</u> . Two <u>depositories, namely, National Securities Depository Limited and Central Depository Services Limited</u> , are in place to <u>provide electronic transfer of securities</u> . All <u>actively traded scrips are held, traded and settled in demat form</u> .		1
5. The <u>securities pay-in obligations of members / custodians are downloaded by the clearing agency</u> .		1/2
6. The <u>members / custodians make available the required securities</u> in their <u>pool accounts with Depository Participants (DPs)</u> by the <u>prescribed pay-in time for securities</u> .		1/2
7. The <u>depository runs an electronic file to transfer the securities</u> from the pool accounts of members / custodians with DPs to the <u>DP account of the clearing agency</u> .		1/2
8. As per the <u>allocation schedule</u> determined by the <u>clearing agency</u> , the <u>securities are transferred on the pay-out day</u> by the <u>depository from the DP account of the clearing agency to the DP accounts of members / custodians</u> .		1/2

9. In case of <u>trades settled under account period settlement</u> , the <u>pay-out of securities are effected on the same day in case of trades settled under rolling settlement</u> .		1/2
10. The <u>ownership vests with the buyer as soon as the securities move from DP account of the member / custodian to his DP account</u> .		1/2
11. Select <u>banks are empanelled by clearing agency for electronic transfer of funds</u> wherein the <u>members are required to maintain account balances with such banks</u> and an <u>automated payment of receipt of funds takes place and the system moves very smoothly</u> .		1

\*\*\*\*\*