IPCC – November 2017

AUDIT

Test Code – INJ 8011
Branch (MULTIPLE) (Date : 11.06.2017)

(50 Marks)

Note: All questions are compulsory.

Question 1

a. Incorrect **(1 Mark)**

Teeming and Lading is one of the techniques of suppressing cash receipts and not of inflating cash payments. **(1 Mark)**

Money received from one customer is misappropriated and the account is adjusted with the subsequent receipt from another customer and so on. **(1 Mark)**

b. Incorrect**(1 Mark)**

Letter of weakness is a report issued by auditor stating the weakness in internal control mechanism. **(1 Mark)**

It also suggests measure by which the weakness in the system to be corrected and the control system be made better protected. **(1 Mark)**

Question 2

(a) Foreign Travel Expenses:

(i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc. **(1/2 mark)**

(ii) Verify that the tour programme was properly authorized by the competent authority. **(1/2 mark)**

(iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed. **(1 mark)**

(iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorization for the tour. **(1 mark)**

(v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company, the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates". **(1 mark)**

(b) Receipt of Capital Subsidy:

(i) Refer to application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available. **(1/2 mark)**

(ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc. **(1 mark)**

(iii) See that conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location. **(1 mark)**

(iv) Check relevant entries for receipt of subsidy. **(1/2 mark)**

(v) Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements. . **(1 mark)**

(c) Royalties received:

(i) Verify the relevant contract and ascertain the provisions relating to the conditions of royalty such as rate, mode of calculation and due date. **(1 mark)**

(ii) Check the periodical statements received in respect of books printed, sold and inventory lying at different locations. **(1 mark)**

(iii) Check the computation in the royalty statement and ensure that any deduction or adjustment made from the royalty due is as per agreement conditions. **(1 mark)**

(iv) Verify the provisions for the royalty to be received as at the end of the year. **(1 mark)**

(d) Goods Sent Out on Sale or Return Basis:

(i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited. **(1 mark)**

(ii) See that price of such goods is unloaded from the sales account and the trade receivable's record. Refer to the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited. **(1 mark)**

(iii) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited. **(1 mark)**

(iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing inventory. **(1 mark)**

Question 3

a. Evidence which originates within the organization being audited is internal evidence. Example – sales invoice, copies of sales challan and forwarding note, goods received notes, inspection report, copies of cash memo, debit and credit notes, etc. **(2 marks)**

b. External evidence on the other hand is the evidence that originates outside the client's organization; for example, purchase invoice, supplier's challan and forward note, debit notes and credit notes coming from parties, quotations, confirmations, etc. **(2 marks)**

c. In an audit situation, the bulk of evidence that an auditor gets is internal in nature. However, substantial external evidence is also available to the auditor. Since in the origination of internal evidence, the client and his staff have the control, the auditor should be careful in putting reliance on such evidence. **(1 mark)**

d. It is not suggested that they are to be suspected; but an auditor has to be alive to the possibilities of manipulation and creation of false and misleading evidence to suit the client or his staff. **(1 mark)**

e. The external evidence is generally considered to be more reliable as they come from third parties who are not normally interested in manipulation of the accounting information of others. However, if the auditor has any reason to doubt the independence of any third party who has provided any material evidence e.g., an invoice of an associated concern, he should exercise greater vigilance in that matter. **(1 mark)**

f. As an ordinary rule the auditor should try to match internal and external evidence as far as practicable. Where external evidence is not readily available to match, the auditor should see to what extent the various internal evidence corroborate each other. **(1 mark)**

Question 4

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

   Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained. **(1 Mark)**

2. In case of recurring audits, auditors generally prepare two types of audit files.
   a. **Permanent Audit file**: It includes –Copies of the financial information being reported on and the related audit reports. **(3 ½ Marks)**
      - Information concerning the legal and organisational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.
      - Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
      - A record of the study and evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
      - Copies of audited financial statements for previous years.
      - Analysis of significant ratios and trends.
      - Copies of management letters issued by the auditor, if any.
      - Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
      - Notes regarding significant accounting policies.
      - Significant audit observations of earlier years.

   b. **Current Audit file**: The current file normally includes: **(3 ½ Marks)**
      - Correspondence relating to acceptance of annual reappointment.
      - Extracts of important matters in the minutes of Board Meetings and General Meetings, as are relevant to the audit.
      - Evidence of the planning process of the audit and audit programme.
      - Analysis of transactions and balances.
      - A record of the nature, timing and extent of auditing procedures performed and the results of such procedures.
      - Evidence that the work performed by assistants was supervised and reviewed.
      - Copies of communications with other auditors, experts and other third parties.
      - Copies of letters or notes concerning audit matters communicated to or discussed with the client, including the terms of the engagement and material weaknesses in relevant internal controls.
      - Letters of representation or confirmation received from the client.
      - Conclusions reached by the auditor concerning significant aspects of the audit.
      - Copies of the financial information being reported on and the related audit reports.

Question 5

1. **Trade Payables :**
   a. Check the adequacy of cut off procedure to ensure that transaction of next period are not accounted and all transactions of year end are accounted. **(1 mark)**
   b. Check posting in the bought ledger from books of prime entry. **(1/2 mark)**
   c. Compare the balances in the schedule of trade payables with balances in bought ledger. **(1/2 mark)**
   d. Compare the balances with the confirmation or statement of account received from trade payables. **(1/2 mark)**
   e. Pay special attention to long outstanding items and enquire about the reason thereof. **(1/2 mark)**
   f. Verify subsequent payments and reversal entries in the bought ledger of year end entries. **(1/2 mark)**
   g. See that trade payables are classified and shown in the balance sheet as per requirement of Schedule III to the Companies Act, 2013. **(1/2 mark)**

2. **Advances to Suppliers :**
   a. Examine the bought ledgers to ascertain the debit balance of trade payables and trace the corresponding entry to the cash/bank book. **(1 mark)**
   b. Obtain a schedule of advances to suppliers and verify it with balances in bought ledger. **(1/2 mark)**
   c. Assess the possibility of delivery of goods against advance payment and examine whether provisioning is required. **(1/2 mark)**
   d. Obtain/resort to direct confirmation procedure. **(1/2 mark)**
   e. Ensure proper classification in the balance sheet as per requirement of Schedule III to the Companies Act, 2013. **(1 mark)**
   f. Pay special attention to long outstanding advances and enquire about the reason thereof. **(1/2 mark)**

3. **Borrowings From a Bank:**
   Borrowings from a bank may be either in the form of overdraft limits; or short term or medium term or long term loans. **(1/2 mark)**
   The audit procedures which an auditor may adopt are outlined below-
   a. Ensure that balance as per books of the client and the bank statement tally. In case of difference between the two amounts, reconciliation statement prepared by the client should account for reasons. **(1/2 mark)**
   b. Examine whether borrowings from the bank have been duly authorized. **(1 mark)**
   c. Examine documents to ensure that statutory requirements, if any, with regards to creation and registration charges have been met. **(1/2 mark)**
   d. Examine the loan agreement and ensure that the terms therein have been duly complied with. **(1/2 mark)**
   e. Ascertain the purpose for which loan has been raised and examine whether end use of the funds have been accordingly made. **(1 mark)**

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