

**Note: All questions are compulsory.**

**Question 1**

<u>Letter of Weakness :</u>	
(i) The auditor does compliance procedure to ascertain that the internal control system exist in the entity; it works effectively; it work continuously in the entity during review period.	<b>1 mark</b>
(ii) <u>When he comes across any weakness in the control points, he issues letter of weakness.</u>	<b>1 mark</b>
(iii) <u>Letter of weakness is a report issued by auditor stating the weakness in internal control mechanism. It also suggests measures by which the weakness in the system be corrected and the control system be made better protected.</u>	<b>1 mark</b>
(iv) Lapses in operation of internal control too are reported in the communication of weakness.	<b>½ mark</b>
(v) The communication of weakness is reporting to management of such weakness in design and operation of internal control as have come to notice of auditor during his auditing and it should not be taken to be a review and comment on adequacy of the control mechanism for management purpose.	<b>½ mark</b>

**Question 2**

(a) Payment of taxes

- (i) Obtain the computation of income prepared by the auditee and verify whether it is as per the Income-tax Act, 1961 and Rules made there under. **(1 mark)**
- (ii) Review adjustments, expenses disallowed, special rebates etc. with particular reference to the last available completed assessment. **(1/2 mark)**
- (iii) Examine relevant records and documents pertaining to payment of advance tax, self assessment tax and other demands. **(1/2mark)**
- (iv) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan. **(1/2 mark)**
- (v) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid. **(1/2 mark)**
- (vi) The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account. **(1/2 Mark)**
- (vii) Ensure that the requirements of AS 22 on 'Accounting for Taxes on Income' have been appropriately followed for the period under audit.**(1/2Mark)**

**(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) Sale proceeds of scrap material:**

- (i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage. **(1/2 mark)**
- (ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials. **(1/2 mark)**
- (iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period. **(1/2 mark)**
- (iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years. **(1/2 mark)**
- (v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year. **(1/2 mark)**
- (vi) See that scrap materials sold have been billed and check the calculations on the invoices. **(1/2 mark)**
- (vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it. **(1/2 mark)**

(viii) ) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness. **(1/2 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

#### a. Assets acquired on hire purchase

- Inspect the hire purchase agreement to ascertain the terms and condition, the instalment and amount of interest included in the instalment. **(1 Mark)**
- Ensure that these are treated as assets acquired under finance lease as per AS-19. **(1 /2 Mark)**
- Verify that initial recognition of lease should be as an asset and a liability at equal amounts. **(1/2 Mark)**
- If it is reasonably certain that lessee will get ownership at the end of the term, see that asset is depreciated over its useful life. Otherwise confirm that asset is depreciated over the shorter of its useful life and the lease term. **(1/2 Mark)**
- Ensure that it is shown separately in the Balance Sheet. **(1/2 Mark)**

#### b. Bad debts

- The amount of bad debts should be traced to the schedule of bad debts written off during the year. **(1/2 Mark)**
- Major amount of bad debts in the schedule be taken for scrutiny. **(1/2 Mark)**
- Check that the amount considered in write off had been overdue for long and scrutinize the correspondence files. **(1/2 Mark)**
- Check the authority for write off and the level of authority is sufficient higher than the executive involved in collection. **(1/2 Mark)**
- The bad debts should be properly disclosed in P&L account according to its materiality. **(1/2 Mark)**
- If provision had already been created for bad debts, see that to the extent of actual bad debts written off, the provision is released. **(1/2 Mark)**

#### c. Trademarks and copyrights

- Obtain schedule of Trade Marks and Copyrights duly signed by the responsible officer and scrutinise the same and confirm that all of them are shown in the Balance Sheet. **(1/2 Mark)**
- Examine the written agreement in case of assignment of Copyrights and Assignment Deed in case of transfer of trade marks. Also ensure that trade marks and copyrights have been duly registered. **(1/2 Mark)**
- Verify existence of copyright by reference to contract between the another and noting down the terms of payment of royalty. **(1/2 Mark)**
- See that the value has been determined properly and the costs incurred for the purpose of obtaining the trade marks and copyrights have been capitalised. **(1/2 Mark)**
- Verify existence of copyright by reference to contact between the author and the entity and to check the payments of royalty made to author. **(1/2 Mark)**
- Ascertain that the legal life of the trade marks and copyrights have not expired. **(1/4 Mark)**

(vii) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations, as per the principles enunciated under AS 26 on Intangible Assets. **(1/4 Mark)**

**Question 6**

As per SA 230 [R] on "Audit Documentation" the working paper are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement	<b>2 marks</b>
Working papers are the important records of the auditor. They serve as evidence of the auditor's exercise of due care and conclusion reached regarding significant matters. The client does not have a right to access the working papers and it is up to the discretion of the auditor to make them available or not to other including the client.	<b>1.5 marks</b>
Hence in the instant case, management of MLS Health Zone can't insist upon the auditor to handover the working papers of the previous year.	<b>1.5 marks</b>

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