

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.	1 mark
(ii) <u>When he comes across any weakness in the control points, he issues letter of weakness.</u>	1 mark
(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>	1 mark
(iv) Lapses in operation of internal control too are reported in the communication of weakness.	½ mark
(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.	½ mark

Question 2

1. Wages paid to seasonal labourer

- Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers. **(1/2 mark)**
- Examine that these labourers are hired on proper authority and the rates of pay are authorized at appropriate levels. **(1/2 mark)**
- Ensure that the attendance is properly checked by the Time Keeping Department. **(1/2 mark)**
- Check that the certificate regarding work done by the labourers has been given by the proper person, in case the labourers have been appointed on a per piece basis. **(1/2 mark)**
- Check the computation of wages payable to the labourers, after taking into account the deductions. **(1/2 mark)**
- Confirm that all the payments to the labourers have been acknowledged. **(1/2 mark)**
- See the time and job records, to ensure that the labourers have been paid for time worked. See the treatment of abnormal idle time. **(1/2 mark)**
- Reconcile the number of seasonal labourers on payroll as per the Personnel Department's records vis-à-vis the number of labourers to whom the wages have been paid, to ensure that there are no ghost workers. This assumes greater importance, if the seasonal labourers are hired on temporary basis, and not on permanent payroll. **(1/2 mark)**

2. Receipt of Capital Subsidy:

- 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)**
- 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)**

3. 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)**

4. Goods Sent Out on Sale or Return Basis:

- a. 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)**
- b. 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)**
- c. 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)**
- d. 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

<u>General Considerations in Framing a System of Internal Check:</u>	
<u>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”.</u>	1
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.	1

(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.	0.5
(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.	0.5
(iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.	0.5
(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.	0.5
(vi) The system of Budgetary Control should be introduced.	0.5
(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.	0.5
(viii) The financial and administrative powers should be sub divided very judiciously and the effect of such division should be reviewed periodically.	0.5
(ix) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.	0.5

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. Advances to Suppliers :

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

2. 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-

- 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)**
- Examine whether borrowings from the bank have been duly authorized. **(1/2 mark)**
- Examine documents to ensure that statutory requirements, if any, with regards to creation and registration charges have been met. **(1/2 mark)**
- Examine the loan agreement and ensure that the terms therein have been duly complied with. **(1/2 mark)**
- Ascertain the purpose for which loan has been raised and examine whether end use of the funds have been accordingly made. **(1/2 mark)**

3. Assets acquired on hire purchase

(i) Inspect the hire purchase agreement to ascertain the terms and condition, the instalment and amount of interest included in the instalment. **(1 mark)**

(ii) Ensure that these are treated as assets acquired under finance lease as per AS-19. **(1/2 mark)**

(iii) Verify that initial recognition of lease should be as an asset and a liability at equal amounts. **(1/2 mark)**

(iv) 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)**

(v) Ensure that it is shown separately in the Balance Sheet. **(1/2 mark)**

4. Endowment policy :

a. 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. **(1 mark)**

- b. Verify the terms and conditions of policies and ensure that all such conditions are in force and being followed. **(1 mark)**
- c. Check that premium has been deposited in time and the policy is in force. **(1 mark)**
- d. Examine that proper disclosures have been made in the financial statements in respect of items for which the policy has been taken. **(1 mark)**

Question 6

Answer :	
<u>Internal Control Questionnaire (ICQ) and Internal Control Evaluation (ICE):</u>	
<u>The internal control questionnaires show the area where weakness occur or likely to occur. They do not give any idea of the importance of those weaknesses. The Internal Control Evaluation brings to light importance of those weakness disclosed by ICQ.</u>	6
Main points of distinctions are :	
(i) ICQ incorporates a large number of detailed questions but does not attempt to distinguish their relation in materiality. ICE isolates the main control objectives within the area of review. (ii) Weaknesses are highlighted by answer “Yes” on ICE compared with ‘No’ on ICQ. (iii) Answer ‘no’ in ICQ indicates a weakness real or potential, but its significance is not revealed. Whereas ICE requires audit personnel to state whether, an apparent weakness may prove to be material in relation to the accounts as a whole. (iv) The ‘Control Checklist’ in ICE is more than a summary of key control factors, and is no substitute for ICQ.	4
