INTER CA – MAY 2018

PAPER 6 : AUDITING AND ASSURANCE
Branch: Multiple Date:

Note: All questions are compulsory.

Question 1

A)

1. Extent of deviation from normal: The necessity for maintaining such huge balances of cash should be ascertained and the Auditor shall satisfy himself for such large balances. The normal requirements of the Company should also be considered in this regard.(2 marks)
2. Cash verification procedures: The Auditor should conduct surprise verification after the year-end, to ascertain whether the actual on hand agrees with the balance as shown by the books of account. If the balances do not agree, the Auditor is duty bound to call for an explanation for the difference. (2 marks)
3. Qualification: When explanation is not forthcoming or no satisfactory explanation is being given for the material difference, the Auditor should draw the attention of the members of the Company to this fact through his Audit Report. (1 marks)

B)

1. ' Qualification by Principal Auditor: The Principal Auditor should qualify his report or disclaim an opinion when he concludes, based on his procedures, that -
   (a) He cannot use the work of the Other Auditor, and
   (b) He has not been able to perform sufficient additional procedures with respect to the Financial Statements of the component reported on by the Other Auditor. **(2 marks)**
2. Effect of Qualification by Other Auditor:
   (a) When the Other Auditor gives a Qualified Report, the Principal Auditor should consider the nature and significance of the subject of qualification, in relation to the Financial Statements as a whole, and accordingly qualify his report.
   (b) The manner in which to deal with the Branch Audit Report is left to the best judgement of the Statutory Auditor, to decide the prima facie relevance and impact of the Branch Audit Report on the Company Accounts.
   (c) The Statutory Auditor has to exercise his professional judgment for reporting, and is not bound to necessarily incorporate the qualifications of the Branch Auditor in his report. **(3 marks)**

C)

Particulars	Audit Report	Audit Certificate
Meaning **(1 mark)**	An Audit Report is an expression of opinion, on the "true and fair view" presented by Financial Statements.	'Certificate' is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion.
Utility **(1 mark)**	The term Audit Report is used when the Auditor expresses his opinion on the Financial Statements.	The term Certificate is used when the Auditor verifies certain exact facts, e.g. Royalty Payment made to Foreign Collaborators, Value of imports or exports of a Company during a financial year.
Implication **(1.5 mark)**	Audit Report implies that - he has examined relevant records in accordance with generally accepted Auditing Standards, and he is expressing an opinion whether or not the Financial Statements represent a true and fair view of the state of affairs and of the working results of an enterprise.	An Auditor's Certificate implies that - (a) he has verified certain precise figures, and (b) he is in a position to vouchsafe their accuracy as per the examination of documents and books of account produced before him.

Accuracy **(1.5 mark)**	When an Audit Report is issued, the Auditor is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.	When a Certificate is issued, the Auditor is responsible for the factual accuracy of what is stated therein.

D) The Auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from –

Aspect	Examples
Circumstances beyond the control of the Entity**(1.5 mark)**	a) The Entity's Accounting Records have been destroyed. b) The Accounting Records of a significant component have been seized indefinitely by Governmental Authorities.
Circumstances relating to the nature or timing of the Auditor's work**(2 mark)**	a) The Entity is required to use the Equity Method of Accounting for an Associated Entity, and the Auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the Equity Method has been appropriately applied. b) The timing of the Auditor's appointment is such that the Auditor is unable to observe the counting of the Physical Inventories. c) The Auditor determines that performing substantive procedures alone is not sufficient, but the Entity's controls are not effective.
Limitations imposed by Management**(1.5 mark)**	a) Management prevents the Auditor from observing the counting of the Physical Inventory. b) Management prevents the Auditor from requesting External Confirmation of Specific Account Balances.

Question 2 (2 marks each)

1. Correct: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
2. Incorrect. Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures.
3. Incorrect: Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriation is the measure of the quality of audit evidence.
4. Incorrect. The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.
5. Incorrect. As per the Standard on Auditing (SA) 520 "Analytical Procedure s" 'the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non -financial data.
6. Incorrect: As per section 141(3) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a Director or is in the employment of the Company as a director or Key Managerial Personnel.
7. Incorrect: The provisions of Companies Act, 2013 grant rights to the auditor to access books of account and vouchers of the company. He is also entitled to require information and explanations from the company. Therefore, he has a statutory right to inspect the minute book.
8. Incorrect: According to section 139(7) of the Companies Act, 2013, in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the co mpany.If C&AG fails to make the appointment within 60 days, the Board shall appoint in next 30 days.
9. Incorrect: As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if he is holding any security of or interest in the company.

10. Incorrect: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Question 3

A)

1. Meaning: Examination in Depth means examination of a few selected transactions from the beginning to the end through the entire flow of the transaction. It involves studying the recording of transactions at the various stages through which they have passed.(1 mark)
2. Aspects of Verification: (1 mark)
   (a) At each stage, relevant records and authorities are examined, it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so.in terms of the prescribed procedure.
   (b) While auditing in depth, the Auditor reviews all the accounting and operational aspects of the transaction from the origin to the end. This enables him to have an overall view and evaluate the procedures through selected transactions.
3. A Representative Sample must be chosen and each item selected must be traced meticulously. (0.5 mark)
4. A smaller number of transactions are checked at each successive stage with a in-depth test, on statistical grounds (based on probability theory) that the optimum sample size decreases as the Auditor's "level of confidence" concerning the functioning of the system increases. (0.5 mark)
5. Examination in depth reconstructs the audit trail and reveals more about the functioning (or malfunctioning) of the Client's system in practice than the haphazard and mechanical approach to testing. (0.5 mark)
6. Example: Auditing-in-depth of transactions relating to purchase of goods involves verification of the following aspects -(0.5 mark)
   (a) Purchase Requisition - pre-printed, pre-numbered and authorized,
   (b) Invitation of quotations and analysis of the same,
   (c) Official Purchase Order, sequentially pre-numbered, authorised and placed with approved Suppliers only,
   (d) Receipt of goods, together with Delivery Challan / Advice Note,
   (e) Admission of goods to stores after verification of quality, quantity, etc.
   (f) Entry in Stores Records,
   (g) Receipt of Supplier's Invoice and Statement,
   (h) Approval of Purchase Invoice regarding compliance for specification, quantity and quality,
   (i) Entries in Purchases Day Book,
   (j) Postings to Purchase Ledger and Purchase Ledger Control Account,
   (k) Payment of Cheque in settlement of invoice after availing discounts, if any,
   (l) Entry for payment in Cash / Bank Book,
   (m) Posting from Cash Book to Ledger and Control Accounts.

B) Overall Audit Approach: The Auditor must gather sufficient appropriate audit evidence as a basis for forming his opinion on -(0.5 mark)

- Truth and fairness of the Financial Statements and their compliance with Statutory Provisions, Rules, etc.
- Proper maintenance of accounting records and other records, books and registers.

The Auditor should determine whether -(0.5 mark each)

1. All Assets & Liabilities are properly stated and classified on a basis consistent with that of the previous year.
2. Securities for Liabilities in respect of assets charged or secured, etc. are properly disclosed.
3. Statutory Provisions, Rules and Regulations made thereunder, documents created under law, e.g. Memorandum of Association, Loan Agreements and other documents, etc. to which the Client is a party, have been complied with.

4. Income and Expenses are properly classified, disclosed and are properly matched, and that they relate to the period in which they are reported and have been determined on a basis consistent with that of previous year.
5. All contingencies and commitments are properly disclosed.
6. No material omissions have been made in the Financial Statements.
7. No material error or inaccuracy in reporting or disclosing Income, Expenses, Assets and Liabilities has been created in the Financial Statements.

C) Internal Control Questionnaire (ICQ):

(a) Meaning: Internal Control Questionnaire is a set of questions designed to provide a thorough view of the state of Internal Control in an organisation. The questionnaire is usually issued to the Client and the Client is requested to get it answered by the concerned executives and employees. (1 mark)

(b) Contents: These questions are generally prepared in sections of distinct control areas like - (i) Purchases & Creditors, (ii) Sales and Debtors, (iii) Stocks, (iv) Cash and Bank Receipts and Payments, (v) Fixed Assets, etc. These are often further segmented into sub-sections. (1 mark)

(c) The purposes of ICQ are -(2 marks)

- Identifying weaknesses: Weaknesses in the Internal Control System can be known by examining answers to the questions in the ICQ and testing whether the procedure or control stated to be operating is actually in operation.
- Extent of Checking: ICQ Analysis enables the Auditor to decide the extent and depth of checking required in accounting areas and can pursue his work more objectively.
- Proper Sampling: ICQ analysis helps the Auditor to select samples in a rational manner. He can adopt a more detailed checking in weak control areas and can subject the rest to normal checking, for deriving the necessary audit satisfaction.
- Audit Planning: The audit programme can be modified if considered necessary, in the light of knowledge given by the questionnaire. The programme can be tailor-made to the needs of the specific situation.

D) Conventional vs Computerised Accounting

Particulars	Conventional Accounting System	Computer Based Accounting System
1. Input Documents(1 mark)	Transactions are recorded from source / input documents, e.g. Bills, Invoices, Receipts, Vouchers, etc.	Data is entered "live" in an online system at the time of transaction itself. Hence no input documents are used.
2. Design(0.5 mark)	Easy to design.	More time-consuming to design.
3. Effect on Organization structure(0.5	Accounting and book-keeping functions are centralised in the Finance Department.	The activities and responsibilities may be centralised in the IT Department, unless all departments are fully computerised and linked by network, (e.g. LAN)
4. Complexity(1 mark)	Less complex relationships between sub-systems, e.g. Purchase, Stores, Accounts, Production, etc.	More complex and high-degree of inter-relationships between different sub-systems.
5. Reliability(0.5 mark)	Possibility of collusion in order to override the system cannot be discounted. Hence less reliable.	Due to effectiveness of controls, it is considered more reliable.
6. Audit Trail(0.5 mark)	Fully visible - all ends of the transactions can be neatly and clearly traced.	Due to absence of Input Documents and storage of information inside the system, audit trail is less visible.

Question 4

A) Sale Proceeds of Junk / Rejected / Scrap Materials

Aspect	Matters to be verified / Auditors' Duties
Internal Control(1 mark)	Examine whether the control system for - (a) generation, (b) storage, (c) identification, (d) disposal, and (e) accounting of Junk Materials or Scrap, is working satisfactorily.

Production Registers(1 mark)	• Review the nature and extent of records maintained for junk materials. • Compare the actual scrap quantity during the period with standards set for normal loss, if any, in the Cost Accounting System. • Examine whether the percentage of scrap to production / consumption quantity, (i.e. loss and yield) is in tune with the industry norms, and inquire into abnormal variances if any.
Invoice Copies(0.5 mark)	• Verify whether all junk materials have been billed and check calculations on rates. • Compare the rate of disposal of current year, with that of previous year and obtain explanations for abnormal differences. • Examine whether the Internal Control System ensures that good quality materials are not billed as "Junk Material / Scrap" to interested parties, at lower rates.
GST Returns(0.5 mark)	• Examine the records maintained under GST Rules and compare the same with the amounts and quantities recorded in the books of accounts. • Examine the GST Returns and compare the same with books of accounts.
Companies Act Requirements(0.5 mark)	• If the maintenance of Cost Records is prescribed under Companies Act, such accounts and records have to be prepared and maintained properly, showing details of Junk / Rejected / Scrap Materials.
Financial Statements(0.5 mark)	• Compare the income generated from sale of junk materials with preceding years. In case of substantial differences, call for adequate explanations. • Check whether Closing Stock of Scrap, if any, has been valued and disclosed properly.

B) Postage and Courier Expenditure

Aspect	Matters to be verified / Auditors' Duties
Internal Controls(1 mark)	• Examine the Internal Control in respect of Petty Cash Payments, and note the authorization procedure in respect of Postage and Courier Expenditure / Unused Postage Stamps / Prepaid Post Covers, etc. • See whether such controls have operated effectively over the period of audit.
Petty Cash Book(1 mark)	• Examine the Petty Cash Book and test-check the entries relating to Postage and Courier Expenditure, for a few months. • Vouch the expenditure with respect to supporting documents, wherever applicable.
Despatch Register(0.5 mark)	Cross-check a few cases of Postage / Courier Expenses with the Despatch Register / Outward Mail Register, to see whether any mail has been sent on that day.
Acknow ledgem(0.5 mark)ents	Where Postage Expenses are recorded in respect of Registered Post / Speedpost with "Acknowledgement Due", examine a few cases whether these "Acknowledgements" are being received from the parties.
Agreement with Courier Company(0.5 mark)	• Where agreements are entered into with a Courier Company / Agency for settlement of bills on a monthly basis, see whether the internal control procedure for authorizing payments (at the month-end) is operating effectively. • See whether TDS has been deducted and remitted properly wherever applicable, for Courier Contracts.
General Ledger/ Financial Statements(0	• Verify whether year-end adjustments have been properly accounted in respect of Postage Stamps in Hand. • Compare the amount of Postage Expenditure of the current year, with that of previous year, to ensure reasonableness.

C) Discounted B/R dishonoured

Aspect	Matters to be verified / Auditors' Duties
Bill-wise Schedule (1	Obtain a Schedule of Bills Discounted dishonoured and examine the same.
Bank Statement(1 mark)	• Trace the credit entry and subsequent dishonour entry in the Bank Statement. • Confirm that no debit is raised by the Banker for dishonour, without first crediting the amount to Entity's account.
Bill Receivable(01 mark)	• Verify whether B/R has been returned along with Banker's advice. • Ensure that the dishonour has been properly "noted" on the B/R.

Debtors Ledger(0.5 mark)	• Verify entries for dishonour passed in the Parties account. • See whether Bank Charges, Noting Charges, etc. have been debited to party.
Lawyer Correspondence (0.5 mark)File(0.5 mark)	Examine correspondence with lawyer and other subsequent events, which may provide other evidence of the debt becoming doubtful or bad.

D) Loans on Mortgage of Property (1 mark)

Mortgage means a charge on immovable property to secure a debt. There are two kinds of mortgages, viz. -

- Simple or Equitable Mortgage - created by the deposit of title deeds of property with a memorandum, applicable in notified towns and cities u/s 58(f) of the Transfer of Property Act, 1882,
- Legal Mortgage - created by Registration u/s 59 of the Transfer of Property Act, 1882.

Aspect	Matters to be verified / Auditors' Duties
MOA / AOA(1 mark)	• Examine the MOA / AOA to see whether the Company is empowered to borrow money, by way of mortgage. • Ensure compliance with Sec. 180 of Companies Act, 2013, as regards maximum loan amount that the Company can raise or borrow.
Minutes and Resolutions(0.5 mark)	• Check the Minutes Book and Resolution approving the borrowal. • Ascertain that the purpose of the borrowings and the manner of utilisation is acceptable and that it does not prejudicially affect the concern. • Note the nature of mortgage, i.e. Equitable or Registered.
Mortgage Deed(0.5 mark)	• Examine the copy of Mortgage Deed for verifying the amount of loan raised, rate of interest, terms of repayment agreed to and rights created in the property. • In case of equitable mortgage with Bankers, obtain acknowledgement or certificate regarding the description of documents held as Equitable Mortgage.
Discharge / Release Deed(0.5 mark)	• If any mortgage has been discharged during the year, examine the receipts in respect of amount paid and Discharge / Release Deed. • Check whether the creation of Mortgage and its satisfaction, if any, has been properly communicated to the ROC.
Financial Statements(0.5 mark)	Confirm that particulars of the mortgage or charge created on asset(s) have been properly disclosed in the Balance Sheet.

Question 5

A) Advantages of Statistical Sampling

1. Appropriateness: Statistical Sampling will be appropriate under the following conditions -(1 mark)
   (a) Large Population: A large population needs to be checked,
   (b) Homogeneity: The population consists of similar items,
   (c) Selectable Items: Items for checking are easily selected and located, and
   (d) Low risk: The error rate is reasonably low (e.g. a good system of internal control in force).
2. Advantages: Advantages of Statistical Sampling include -(2 mark)
   (a) Sample Size Control: The amount of testing (sample size) does not increase in proportion to the increase in size of population (universe).
   (b) Objectivity: The sample selection is more objective, unbiased and thereby more reasonable in evaluation of audit evidence.
   (c) Risk Assessment: It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures. The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
   (d) Better Analysis: It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not large.
   (e) Economy: Time and money are saved by limiting sample size to the extent that is required to achieve a given result.

3. Selection of an audit sample on random basis is the pre-requisite for application of statistical techniques. (0.5 mark)
4. The audit sample collection on a random basis ensures that all items in the population have an equal chance of selection, for example, by use of random number tables. (0.5 mark)

B) (1 mark each)

1. Substantial Repair Expenses:
   (a) Ascertain whether the expenditure has resulted in addition to the asset's value or has contributed to higher productivity of the machinery. If necessary, the Report of a Engineer / Valuer may be obtained.
   (b) When substantial addition to the asset is proved, the expenditure should be capitalised. Expenses, which are essentially of revenue nature, if incurred for creating an asset or addition to its value or achieving higher productivity are regarded as expenditure of a capital nature.
   (c) When there is no substantial addition to the asset, the expenditure should be written off to P&L A/c.
   (d) Apparently, "substantial" should be differentiated from "normal" repairs. However, the real purpose and effect of the expenditure forms the criterion for Capital - Revenue distinction.
   (e) Verify whether there is any insurance claim for the substantial repairs expenditure incurred. See whether the same has been properly accounted.
   (f) Compare the amount of repairs expenditure incurred with that of previous years and also with the condition of the asset, so as to ascertain whether it is reasonable.
2. Removal of "Overburden" to facilitate mining:
   (a) The benefit of such expenditure will be enjoyed so long as mineral can be raised.
   (b) Hence, it amounts to Deferred Revenue Expenditure, the benefit of which is not exhausted within the year in which it has been spent.
   (c) Such expenditure should be charged off to Profit and Loss Account spread over various years of extraction, on the basis of quantity of mineral to be extracted every year.
3. New Product Advertisement Expenditure:
   (a) The advertisement expenditure was incurred to launch and introduce a new product in the market.
   (b) It is neither an expenditure for increasing the sales for that particular year or sustaining the market share for that year. Also, the benefits of this campaign will be enjoyed for a number of years to come.
   (c) Hence, such expenditure should be treated as Deferred Revenue Expenditure.
   (d) It should be charged to P&L Account over the period for which the benefit will be enjoyed.
4. Pre-production Training Expenditure:
   (a) Training Expenses are generally charged off to revenue, as they are incurred for upgrading and updating the existing skills of employees, the benefit of which is of a short-term recurring nature.
   (b) When a new Company incurs such expenses on behalf of technical personnel, it cannot be treated as regular training expenditure. Such training is being organised as a new production process or when a product is being introduced.
   (c) Hence, such expenditure should be treated as Deferred Revenue Expenditure and written over a period of years, as the benefits from such training will be enjoyed over a number of years to come.

C) (1 mark each)

1. Ordinary Business at AGM:
   (a) The appointment of Auditors at the AGM is one of the items of ordinary business to be transacted at that meeting.
   (b) The Company shall place the matter relating to appointment of Auditors, for ratification by Members, at every AGM, by way of passing an Ordinary Resolution.
   (c) If the appointment is not ratified by the Members of the Company at the AGM, the Board of Directors shall appoint another Individual / Firm as the Auditor(s), after following the procedure laid down in this behalf under the Act.
2. Need for Resolution: The Companies Act requires some action on the part of the Company resulting in the appointment of Auditor / re-appointment of the Retiring Auditor. So, a specific resolution is required appoint the Auditor. He cannot be deemed to be appointed or re-appointed automatically at the AGM (i.e. without any resolution).
3. Sec. 139 Requirement: For appointing a person other than the Retiring Auditor, full compliance with Sec. 139 is necessary. Non-compliance would render the appointment of the new Auditor illegal and ineffective. Hence, in the given case, the appointment of X 8i Co, CA's, is invalid.

4. Conclusion: In the given casg, the Company has not properly appointed X 8t Co, or validly re-appointed Z 8i Associates at its AGM. Hence, Z Associates cannot continue as Auditors of the Company for the year 2014-2015.

D) (1 mark each)

1. Nature of Cost Audit [Sec. 148(3)]: Cost Audit is not a substitute for Annual Financial Audit. The Cost Audit u/s 148 shall be in addition to the regular Financial Audit conducted by the Statutory Auditor appointed u/s 139.
2. Reporting Requirements of Statutory Auditor: The Statutory Auditor has to report u/s 143(3) "whether in his opinion, proper books of account as required by law have been kept by the Company, so far as it appears from his examination of those books". Proper Books of Account includes the Cost Records stipulated u/s 148. The Statutory Auditor's duties cannot be limited in any way either by the Articles or Directors or Members.
3. Rights of Access to Books of Account: Sec. 143(1) grants the Company Auditor with the right to access at all times, the books and accounts and vouchers of the Company. He derives his powers from the Companies Act, on the consideration that such powers are essential for a proper performance of duties.
4. Judicial Decision: In Newton vs. Birmingham Small Arms Co, it was held that any regulations which preclude the Auditors from availing themselves of all the information to which they are entitled under the Companies Act, are inconsistent with the Act and hence Null and Void.
5. Conclusion: Hence, the Auditors cannot be requested not to review the Cost Records since the Company has appointed a Cost Auditor. The Auditor can, however, review the Report of the Cost Auditor to form up his own opinion.

Question 6

A) Considerations in framing Internal Check (1 mark for each point)

The general considerations in framing a system of Internal Check are -

1. Different Hands: No single person should have an independent control over any important aspect of the business. All dealings and acts of every employee should, in the ordinary course, come under the review of another.
2. Job Rotation: The duties of staff members should be changed from time to time without any previous notice. The same officer or sub-ordinate should not, without a break, perform the same function for a considerable period of time.
3. Leave: Every member of the staff should be encouraged to go on leave at least once in a year. Frauds successfully concealed by employees are often unearthed when they are on leave.
4. Assets - Books Differentiation: Persons having physical custody of assets should not be permitted to have access to the books of account.
5. Asset Verification: There should be an accounting control in respect of each important class of assets. They should be periodically inspected so as to establish their physical existence.
6. Mechanical devices: Mechanical devices such as Automatic Cash Register, Cash Counting Machines, etc. may be employed to prevent loss or misappropriation of cash.
7. Stock Taking: During year-end stock-taking, trading activities should, preferably, be suspended. Stock-taking and evaluation should not be done exclusively by the Stores Staff. Employees from other departments and sections should be employed for this task.
8. Delegation of Powers: Financial and administrative powers, e.g. signing of cheques, verification of assets, etc. should be distributed very judiciously among different officers and the manner in which these are actually exercised should be reviewed periodically.
9. Review of accounts: Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.
10. Review of Procedures: Accounting procedures should be periodically reviewed since even well designed and carefully installed procedures may become ineffective and redundant in due course.

B)

1. As per the CA Act, 1949 and Schedules thereto, a Chartered Accountant should not express his opinion on the Financial Statements of any business or enterprise in which he, his Firm, or a Partner in his Firm has a substantial interest. (1 mark)
2. The following persons are disqualified u/s 141(3) -(2 mark)
   (a) a Person who, or his Relative or Partner is holding any security of or interest in the Company or its Subsidiary, Holding or Associate Company or a Subsidiary of such Holding Company.

(b) a Person whose Relative is a Director or is in the employment of the Company as a Director or Key Managerial Personnel.

3. So, the Firm / Partner is not qualified to be appointed as Company Auditor, since his relationship is likely to affect his duties as an Auditor and impair his independence. (1 mark)

C)

1. General Principles: There are no specific disclosure requirements for Deferred Payment Liabilities under Schedule III. The same should be disclosed on the basis of sound accounting principles and generally accepted accounting practices prevailing in the country, considering the general requirements of Sec. 129. (2 mark)
2. Nature: Deferred Payment Liability should be disclosed keeping in view the nature of the liability. It is not in the nature of Loan as per common commercial parlance. (1 mark)
3. Disclosure: The instalments of Deferred Payment Liabilities payable within 12 months of the Balance Sheet date must be disclosed as "Other Current Liabilities" while the other instalments i.e. Long-Term Liabilities, should be disclosed under "Other Long Term Liabilities".(1 mark)

Question 7

A) Capital vs Revenue Expenditure (1 mark for each point)

Particulars	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure incurred for the purpose of – (a) acquiring, extending or improving assets of a permanent nature for carrying on the business, or (b) increasing the earning capacity of the business.	It is an expenditure, the benefit of which is immediately (normally within one year) expended or exhausted in the process of earning revenue.
2. Purpose	a) Acquiring Fixed Assets, which are held not for resale, but for use with a view to earning profits. b) Making additions to the existing Fixed Assets. c) Increasing earning capacity of the business by improved facilities and equipments. d) Reducing the cost of production. e) Acquiring a benefit of enduring nature or a valuable right.	a) Actual day-to-day running of the business, b) Maintaining the capital assets in an efficient manner.
3. Treatment in Fin. Stmts	Asset is displayed in the Balance Sheet. Only depreciation portion thereon is debited to P8iL A/c.	Expenditure is charged fully in the Profit and Loss Account.
4. Wrong treatment	If wrongly treated as revenue, profits will be understated or reduced.	If wrongly capitalized, profits will be inflated or overstated.

B) Some of the factors that may be considered to determine whether the Company is dealing or trading in investments or whether it is merely holding investments are as follows -(1 mark for each point)

1. Objects of the Company as stated in the MoA.
2. Period of time for which individual investments are held before they are sold.
3. Reasons, to the extent they can be determined, for purchase or sale of an investment.
4. Internal Procedure, Orders or Directives regarding Purchase and Sale of Investments.
5. Method of Valuation of Investments for Balance Sheet purposes. For example, if Investments are treated as Stock-in- Trade for the purposes of valuation, the indication would be that the Company is an Investment Company.
6. Status given to the Company in its tax assessments, that is, whether it is treated as a Dealer in Investments (taxed as Business Profits) or whether it is treated as an Investor (taxed as Capital Gains).

C) Audit Reports for Co-Operative Societies

1. Submission: The Audit Report should be submitted to the Society. Copies of the Report should be submitted to the concerned authority like District Special Auditor, Deputy Registrar, etc. (1 mark)
2. Form: The Audit Report should be submitted in the prescribed form specified by the Registrar or given in the related Rules. (1 mark)
3. Contents: In his Audit Report, the Co-operative Society's Auditor should state whether -(2 mark)

(a) He has obtained all the necessary information and explanations which were necessary for the audit.

(b) In his opinion and to the best of his information and according to the explanations given to him, the accounts give all the information required by the Act

(c) Profit & Loss Account gives a true and fair view of the Profit / Loss made by the Society.

(d) Balance Sheet gives a true & fair view of the state of affairs of the Society as on the Balance Sheet date.

(e) In his opinion, proper books of account as required by the Act, the Rules and the Bye-laws of the Society are properly maintained.

(f) Balance Sheet and Profit & Loss Account examined by him are in agreement with the books of account and returns of the Society.

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