

Qn. 1 State with reasons (in short) whether the following statements are True or False :

- (i) While conducting audit of Government Companies, the auditors are paid their Professional Fees as prescribed by the Government.
- (ii) The auditor compares entries in the books of accounts with vouchers and if two agrees, his work is done.
- (iii) Confirmations received by the auditor directly from third parties are conclusive evidence in support of a transaction.
- (iv) Audit Committee is to be formed by each and every company and the auditor has no compulsion to attend the meeting of the Audit Committee.
- (v) A company can not declare dividends without providing for depreciation.
- (vi) When an auditor identifies a Misstatement resulting from fraud, it is his responsibility to communicate it to the regulatory and enforcement authorities apart from those charged with governance.
- (vii) The auditor should study the Memorandum and Articles of Association to see the validity of his appointment.
- (viii) A special resolution is required by company to authorise issue of shares at discount.
- (ix) The Investments made by the company in Government Securities like NSC, Government Bonds, etc, should be kept in personal custody of Financial Controller of the Company.
- (x) The company in which 15% of subscribed capital is held by State Financial Corporation and 10% of Subscribed capital is held by General Insurance Co., the appointment of auditor can be done by passing a general resolution at annual general meeting.

Ans. 1 (i) False : As per Sec. 224 (8), in case of an auditor appointed u/s 619 by the CAG that is for govt. companies, auditors remuneration shall be fixed by the company in general meeting or in such manner as the company in general meeting may determined.

Ans. 1 (ii) False : The main objective of audit as per AAS-2 is to express opinion on financial statements. To express opinion he needs to collect evidence in the form of source documents to form conclusion. Thus comparing entries helps auditors to move ahead.

Ans. 1 (iii) False : As per AAS – 5 audit evidence in many cases is persuasive and not conclusive. The best audit evidence is a theoretical concept and is not available in audit situations. The auditors normally relies on prima – facie persuasive evidence. Absolute certainty in auditing is rarely attainable because : -

- (a) The audit work involves judgment
- (b) The nature of evidence is persuasive which enables the auditor to draw only reasonable conclusions there from.

Confirmation received by third part is also a persuasive evidence because with the help of the letter we can say that the debtors are good but they will pay or not, it totally depends upon their discretion, therefore the above statement is false.

Ans. 1 (iv) False : According to section 292A, every listed company having paid up share capital of not less than rupees five crores should have an audit committee. The auditors, the internal auditors and the direct in- charge of finance shall attend and participate in the meetings of the audit committee but shall not be entitled to vote thereat.

Ans. 1 (v) True : As per Sec. 205 of the companies act, no dividend can be paid unless present as well as arrears of depreciation have been provided for out of profits of company.

Ans. 1 (vi) True : Communication - When the auditor identifies a misstatement resulting from fraud or error -

- (i) he should communicate that information to the **appropriate** level of management on a timely basis, and
- (ii) consider the need to report such matters to those charged with **governance** and if required to regulatory and enforcement authorities.
- (iii) The auditor should communicate to the management any material weakness in internal control related to the prevention or detection of fraud and error, which has come to his attention as a result of the performance of the audit.

Ans. 1 (vii) False :: **DUTY OF INCOMING AUDITOR**: Before accepting audit the incoming auditor has following two duties :

(i) He must communicate with previous auditor to ascertain the circumstances which led up to his resignation and to know whether there exist any circumstances on a/c of which he should not accept the appointment.

(ii) He must ascertain whether company has complied with provision of Sec 224, 224A and 225.

If he is not satisfied, he should not accept the appointment.

Therefore for validity purpose, he need not study MOA & AOA but he has to ensure compliance of Sec 224, 224A & Sec 225. .

Ans. 1 (viii) False : As per Section 79 of the Companies Act, 1956, the issue of shares at discount is authorized by an ordinary resolution passed by the company at its general meeting and sanctioned by the Central Government. The resolution specifies the maximum rate of discount. The rate of discount shall not exceed 10% unless allowed by the Central Government. in special circumstances.

Therefore there is no need to pass Special Resolution for this purpose.

Ans. 1 (ix) False : As per GUIDANCE NOTE ON AUDIT OF INVESTMENTS,

(1) Control over acquisition, accretion and disposal of investment :- There should be proper authority for acquisition, sanction and disposal of investment including renunciation of rights.

(2) Safeguarding of investment -The investment should be in name of company except as allowed by law. There should exist a proper system for safe custody of all scripts or other document of title.

The investments made by the company in govt. securities like NSC, Govt bonds etc. shall be held by the entity itself or may be held by others in some cases example may be held in DMAT form or by banks etc. But it shall not be kept in the personal custody of the financial controller.

Ans. 1 (x) False. APPOINTMENT OF AUDITOR BY PASSING SPECIAL RESOLUTION (224A)

In the case of a company in which not less than **25%** of the **subscribed share capital** is held, whether singly or in any combination by ;

i) A public financial institution or a Govt. Co. or a State Govt. or Central Govt.

ii) Any financial or other institution established by any provincial or state act in which a State Govt. holds not less than 51% of the subscribed share capital or

iii) A nationalised bank or

iv) An insurance company carrying on general insurance business.

the appointment/re-appointment at each AGM of an auditor shall be made by passing special resolution.

In this question 25% subscribed share capital is held jointly by State financial corporation & General Insurance Company, therefore appointment of auditor by passing Ordinary Resolution is not correct.

Qn. 2 Comment on the following situations :

(a) Mr. Y was appointed as an auditor of PQR Ltd. for the year ended 31.3.2009 at Annual General Meeting held on 16.08.2008. Mr. Y has been indebted to the company for sum of Rs. 10,000 as on 1.4.2008, the opening date of accounting year which has been subject to his audit. However, Mr. Y having come to know that he might be appointed as auditor, he repaid the amount on 10.8.2008. One of the shareholders, complains that the appointment of Mr. Y as an auditor was invalid because he incurred disqualification u/s 226 of the Companies Act, 1956.

(b) XYZ (Pvt.) Ltd. has paid up Capital and Reserves of Rs. 60 lac's and secured Loans of Nationalised Banks having sanctioned limit of Rs. 28 lacs and outstanding balance of Rs. 23 lacs. The turnover of the company is 5.10 crores for the year ended 31.3.2009. A customer returns goods worth 40 lacs on 2.4.2009, out of sales made during the year ended 31.3.2009. The management of CO. is of the opinion that CARO, 2003 is not applicable to the company.

(c) C Ltd. declared dividend amounting to Rs. 5 lacs out of Profits for the year ended 31.3.2009.

Subsequently, it was noticed that company had failed to make provisions for Outstanding expenses of Rs. 7.80 lacs and Closing stock was also over valued, which was not reported by auditors of the company. Management of C Ltd. holds auditors responsible for this situation.

Ans. 2 (a) DISQUALIFICATION OF AN AUDITOR 226 (3)

None of the following persons shall be qualified for appointment as auditor of a company :

a) A body corporate

b) an officer(including director) or employee of company.

c) A person who is a partner or who is in employment, of an officer or employee of the company.

d) A person who is indebted to the company for an amount exceeding Rs.1000/- or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding 1000/-.

e) A person holding any security of that company carrying voting rights.

Section 226 (5) provides that if an auditor becomes subject to any of disqualification as per 226(3) or 226(4), after his appointment then he shall vacate his office.

As per sec. 226 (3) as on date of appointment he should not be covered under any of disqualification mention above. Thus date of appointment is important and not for the period for which audit is conducted.

As per the question appointment took place on 16.08.2008 on which date auditor was not a debtor. He was indebted to company on 1st April 2008 and repaid the amount before his appointment. Hence he is not disqualified and his appointment is valid as per Section 224..

Ans. 2(b) : Section 227(4A) states that the Central Govt. may by general or special order, direct that, in the case of such class of companies as may be specified in order, the auditor's report shall also include a statement on such matters as specified thereon. The above section apply to any company except -

a private limited company with a paid-up capital and reserves not more than **rupees fifty lakhs** and which does not have outstanding loan exceeding rupees **twenty five lakhs** from any bank or financial institution and does not have a turnover exceeding **rupees five crores** at any point of time during the financial year.

In this question, the paid up capital & free reserves of the company exceeds Rs. 50 lacs as well as the turnover of the company exceeds Rs. 5 crores at any point of time during the financial year. Subsequent return of goods by the customer will not be considered because the section says turnover exceeds Rs. 50 crores at any point of time during the financial year. Therefore the contention of the management is not correct & the provisions of CARO 2003 is applicable to the company.

Ans. 2 (c) "OBJECTIVE AND SCOPE OF AUDIT OF FINANCIAL STATEMENT" (AAS-2) -

1. Objective : The main objective of audit is to express opinion on financial statement. The secondary objective of audit is detection & prevention of fraud & errors involved in the financial statement.

The objective of an audit of financial statement is to enable an auditor to express an opinion on such financial stat. The opinion help in determining true and fair view. The user, however, should not assume that auditor's opinion is an assurance to the future viability of enterprises or the efficiency or effectiveness with which management has conducted the affairs of enterprise.

Management is responsible to prepare accounts. Audit won't relieve them of this responsibility.

Responsibility for detection of fraud and error – As per AAS 4, prevention and detection of fraud and error is the responsibility of the management, and for this purpose it should implement and continuously operate an adequate system of internal control.

In forming his opinion as regards financial information, the auditor carries out procedures to obtain evidence that will provide reasonable assurance that the financial information is properly stated in all material respects. The audit should be planned in such a way that there is reasonable expectation of detecting material misstatement in the financial information resulting from fraud and error.

If the auditor adheres to basic principal governing an audit, e.g. Performance of audit work with requisite skill and competence, he will not be responsible for any subsequent discovery of material misstatement in financial information resulting from fraud or error.

There are some Inherent Limitation of an Audit because of which an auditor cannot be held responsible prima-facie for subsequent detection of material misstatement.

- The test nature of an audit will involve judgement as to the areas to be tested and the number of transactions to be examined.
- Audit evidence in many cases is persuasive, and not conclusive
- Material misstatements resulting from frauds are more difficult to detect than those resulting from errors because frauds will usually involve acts such as collusion, forgery, non-recording of information and misrepresentation to the auditor with a view to conceal frauds.
- Audit programme is drafted only to help the auditor to achieve the objective of framing and expressing an opinion on financial statements.

Conclusion : If the auditor performed his duties as per basic principles governing an audit, then subsequent discovery of errors like non provisions of outstanding expenses and over valuation of closing stock does not make the auditor liable. The contention of the management is not correct.

Qn. 3. A trader is worried that inspite of substantial increase in sales compared to earlier year, there is considerable fall in Gross Profit after satisfying himself that sales and expenses are correctly recorded and that the valuation of inventories is on consistent basis, he wants to ensure that purchases have been truthfully recorded.

How will you proceed with this assignment :

Ans. 3

<p>1. <u>Credit purchases</u> Internal controls ↓ authorization ↓ Purchase invoice ↓ Only w.r.t. goods ↓ Not for personal use ↓ Posting ↓ confirmation</p>	<ol style="list-style-type: none"> 1. Auditor should examine the internal control system in this area. Also examine whether these have been adequately authorised. 2. Examine related purchase invoice & purchase orders. Also check whether an invoice has been sent to the client at his normal business address. 3. It should be checked that it falls within the period under audit. 4. Ensure that purchases of capital assets are recorded in journal and not in purchase book. 5. Castings and carry forwards in purchase book and postings to ledgers should be carefully checked. 6. Ensure that Goods purchased are meant for the purpose of client and not for personal use of directors or officers. 7. Examine entry in sales account as well as in customer's account to ensure their correct posting. 8. Confirmation from supplier should be obtained.
<p>2. <u>Purchase returns</u> ↓ purchase return book ↓ debit notes ↓ inventory records ↓ entry in accounts</p>	<ol style="list-style-type: none"> 1. Examine purchase return book with reference to copies of debit notes issued to suppliers. 2. Ensure that a debit note has been sent to the supplier or credit note from the supplier has been received. 3. Quantity returned as per the return note must be checked with storekeeper's record and return outward register. 4. Examine corresponding entry for purchase return in supplier's account.

- Qn. 4. (a)** Discuss Internal Controls in a CIS Environment.
(b) Differentiate between 'Qualified report' and 'Adverse report'.

Ans. 4 (a)

INTERNAL CONTROLS IN A COMPUTER BASED SYSTEM

ICS in a computer based system is divided into 2 parts - (A) General EDP Controls. (B) EDP Application Controls
(A) GENERAL EDP CONTROLS - These controls are designed to ensure overall control over the EDP activities and to provide a reasonable level of assurance that the overall objectives of internal control are achieved. These may include :-

(a) ORGANISATION AND MANAGEMENT CONTROLS - They are designed to establish an organisational framework over activities, including - i) Policies and procedures relating to control functions.
 ii) Appropriate segregation of incompatible functions (e.g. preparation of transactions, programming and computer operations.)

(b) APPLICATION SYSTEMS DEVELOPMENT AND MAINTENANCE CONTROLS - They are designed to provide reasonable assurance that systems are developed and maintained in an authorised and efficient manner. These may include i) Testing, conversion, implementation and documentation of new or revised systems.
 ii) Changes to application systems.
 iii) Access to system documentation.
 iv) Acquisition of application systems from third parties.

(c) COMPUTER OPERATION CONTROLS - They are designed to control the operation of the systems and to provide reasonable assurance that -
 i) The system are used for authorised purpose only.
 ii) Access to computer operations is restricted to authorised personnel.
 iii) Only authorised programs are used.
 iv) processing errors are detected and corrected.

(d) SYSTEM SOFTWARE CONTROLS - They are designed to provide reasonable assurance that system software are acquired or developed in an authorised and efficient manner. These may include
 i) Authorisation, approval, testing, implementation and documentation of new systems software and systems software modifications.
 ii) Restriction of access to systems software and documentation to authorised personnel.

- (e) **DATA ENTRY AND PROGRAM CONTROLS** - They are designed to provide reasonable assurance that -
- i) An authorisation structure is established over transactions being entered into the system.
 - ii) Access to data and programs is restricted to authorised personnel.

There are other EDP safeguards that contribute to the continuity of EDP processing. These may include -

- i) Offsite backup of data and computer programs.
- ii) Recovery procedures for use in the event of theft, loss or intentional or accidental destruction.
- iii) Provision for offsite processing in the event of disaster.

(B) **EDP APPLICATION CONTROLS** - The purpose is to establish specific control procedures over the accounting applications in order to provide reasonable assurance that all transactions are authorised and recorded, and are processed completely, accurately and on a timely basis. These may include -

(a) **CONTROLS OVER INPUT** -

- i) Transactions are properly authorised before being processed by the computer.
- ii) Transactions are accurately converted into machine readable form and recorded in the computer data files.
- iii) Transactions are not lost, added, duplicated or improperly changed.
- iv) Incorrect transactions are rejected, corrected and, if necessary, resubmitted on a timely basis.

(b) **CONTROL OVER PROCESSING AND COMPUTER DATA FILES** -

- i) Transactions, including system generated transactions, are properly processed by the computer.
- ii) Transactions are not lost, added, duplicated or improperly changed.
- iii) Processing errors are identified and corrected on a timely basis.

(c) **CONTROL OVER OUTPUT** -

- i) Results of processing are accurate.
- ii) Access to output is restricted to authorised personnel.
- iii) Output is provided to appropriate authorised personnel on a timely basis.

Ans. 4 (b) Qualified Audit Report : Qualified audit report is one when auditor does not give a clean chit about the truthfulness and fairness of the financial statements but make certain reservations. In a majority of cases, items which are the subject matter of qualification are not so to affect the truth and fairness of the whole of the accounts but merely create uncertainty about a particular item. In such cases it is possible for the auditors to report that in their opinion but subject to specific qualifications mentioned, the a/c's present a true and fair view. The auditor must clearly express the nature of qualifications in the report. The auditor should also give reasons for qualification.

The Institute of Chartered Accountants of India in its "**Statement on qualifications on auditors report**" has provided that before making a qualified report, the auditor must carefully consider various aspects in proper perspective. He should see

- ✓ as to which of the various items, statements of fact and opinion require qualification;
- ✓ whether he is in active disagreement with something which has been done by the company, or is merely unable to form an opinion in regard to items for which there is lack of adequate information;
- ✓ whether the matters in question are so material as to effect the presentation of a true & fair view of the whole of the affairs of the company, or they are of such a nature as only to affect a particular item disclosed in the accounts; and
- ✓ whether matters constituting qualification involve a material contravention of any requirements of the Companies Act, 1956 which have a bearing on the accounts.

Adverse or Negative Report: The auditor issues a negative report when there is a sufficient basis for the auditor to form an opinion that the accounts and financial statements, taken as a whole, do not present a true and fair view of the state of affairs and the working results of the organisation. It means if the reservations are so material that.

Qn. 5 (a) Draft an audit programme for conducting audit of accounts of a Local Body.

- (b) "The extent of audit procedure performed on corresponding figure is less compared to audit of current period figures", reporting. Justify the statement with regard to auditor's duties for reporting of comparatives under AAS 25.

Ans. 5(a)

Preliminary	Auditor should obtain basic information about the constitution, ^{H1} functions and financial status of the urban local body.
Understand financial administration	◆ Obtain sufficient knowledge about their budget and accounting system.

	<ul style="list-style-type: none"> ◆ The auditor should obtain complete knowledge about the budget as it is an important tool of financial planning and control for urban local bodies.
Vouch income and expenditure	<ul style="list-style-type: none"> ◆ The revenue items may include property tax, collection from public places, grants, etc. ◆ The expenditure may include salary wages, allowances to employees, rent, printing and stationery, repairs and maintenance, etc. ◆ He should vouch income and expenditure account in the usual manner.
Verification of assets and liabilities	<ul style="list-style-type: none"> ◆ Assets may consist of land, buildings, plant and machinery, vehicles, office equipment, furniture and fittings, etc. ◆ Reserve, long-term and short-term loans and unutilized grants are included in the liabilities side. ◆ Verification of assets and liabilities should also be carried out in usual manner.

Audit report : - Finally, he expresses opinion on financial statements. He should also communicate the comparisons of budgeted and actual figures.

Ans. 5 (b) As per **AAS 25 Comparatives**, when comparatives are presented as corresponding figures, the auditor's report should not specifically identify comparatives because the auditor's opinion is on the current period financial statements as a whole, including the corresponding figures. A reference to corresponding figures should, however, be made in circumstances described below.

- When the auditor's report on the prior period, as previously issued, included a qualified/ disclaimer or adverse opinion and the matter which gave rise to the modification remains unresolved, the auditor's report on the current periods figures should be modified regarding the corresponding figures irrespective of whether the auditor's report on the current period figures is modified.
- In case in performing the audit of the current period financial statements, the auditor becomes aware of a material misstatement that affects the prior period financial statements on which an unqualified report has been previously issued, the auditor should examine that appropriate disclosures have been made in the current period financial statements or the auditor should issue a modified report on the current period financials, with respect to the corresponding figures included therein.
- The AAS also requires that when the prior period financial statements are not audited, the incoming auditor should state in the auditor's report that the corresponding figures are un-audited.

Therefore the above statement "The extent of audit procedure performed on corresponding figure is less compared to audit of current period figures" is correct.

Qn 6. (a) 'Doing the audit in EDP environment is simpler since Trial Balance always tallies.
Analyse the statement critically.

(b) 'A Joint Auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report.'
Justify this statement in the light of responsibilities of Joint Auditors under AAS 12.

Ans. 6 (a) Though it is true in an EDP environment the trial balance always tallies, the same cannot imply that the job of an auditor becomes simpler. There can still be some errors of omissions like omission of certain entries, compensating errors, duplication of entries, etc. in the books of account even when the trial balance tallied. In today's complex business environment, the importance of trial balance in an audit has to be gauged not from the view point of arithmetical accuracy but the nature of transaction to be recorded which in fact have become very complex. The emergence of new forms of financial instruments like options and futures, derivatives, off-balance sheet financing, etc. have given rise to further complexities in recording and disclosure of transactions. In an audit besides the tallying of a trial balance, there are also other issues like estimation of depreciation, valuation of inventories, etc. which still require judgement to be exercised by the auditor. The total time taken in an audit where the trial balance has tallied may still be considerably higher than an audit where the trial balance has not tallied. That responsibility will still remain even in an EDP environment. Therefore, simply because of EDP environment and the trial balance has tallied it does not mean that the audit would become simpler.

Ans. 6 (b) AAS – 12 THE RELATIONSHIP AMONG JOINT AUDITORS

In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible -

- (a) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (b) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;
- (c) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (d) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
- (e) for ensuring that the audit report complies with the requirements of the relevant statute.

But it is not necessary that joint auditors should have same view on a specific matter and also a joint auditor is not bound to express views influenced by majority of auditors it may be possible that there are differences of opinion among them regarding the report in such a situation the dissenting joint auditor/(s) must give his or their separate report(s).

When there is difference of opinion among joint auditor on any issue, each joint auditor should have given a separate report expressing his views on a/c's. There is no question of majority or minority with respect to the joint auditor report.

Therefore the statement given in the question 'A Joint Auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report', is correct.

Qn 7. How would you vouch/verify the following ? [5 x 2 = 10]

- (a) Reduction in Share Capital
- (b) Receipt of Capital subsidy.

Ans. 7 (a) Auditor's duties with regard to Reduction of Capital

The auditor's duties in this regard are as under :

1. Verify that the general meeting to pass the special resolution was properly convened. Inspect the minutes of the general meeting to confirm the passage of special resolution.
2. Confirm that articles of the company authorizes the reduction of capital.
3. Examine the Court order confirming the reduction.
4. Ensure that the words "and reduced" are added to the name of the company in the balance sheet, if the order of Court so requires.
5. Verify that a copy of the Court's order and minutes have been filed with ROC.
6. Inspect the ROC's certificate as regards reduction of capital.
7. Verify that the memorandum of the company has been suitably altered.
8. Vouch the journal entries to reduce the capital and write down the assets with shareholder's resolution and other documentary evidence.
9. Verify that requirements of Part I of Schedule VI to the Companies Act, 1956 regarding disclosure of write-down of fixed assets have been complied with.
10. Confirm that either the paid-up amount shown on the old share certificates have been altered or new certificates issued after cancelling the old ones.
11. If reduction is achieved by cancelling fully paid shares proportionately, verify the surrendered shares/issue of stickers/intimation to the depositories vis-a-vis the amount received.

Ans. 7 (b) Capital subsidy/Receipt of special backward area subsidy from Government

- ◆ Vouch the entry for receipt of subsidy with reference to the client's application papers, the Government's letter/memo sanctioning the subsidy and other correspondence and the entry in bank statement.
- ◆ Study the terms of grant of subsidy. Mere receipt does not qualify it to be accounted for as subsidy. Till the recognition criteria specified in AS-12 'Accounting for Government Grants' is satisfied, it should be reflected as a liability in the balance sheet.
- ◆ When recognition criteria is satisfied (*i.e.* it is reasonably assured that entity would comply with the terms of the grant), it should be credited to capital reserve as required by (AS) 12 'Accounting for Government Grants' and is not available for distribution as dividend.

- ◆ According to ICAI's "Guidance Note of Audit of Capital and Reserves", this treatment prescribed by (AS) 12 should be followed even in the case of proprietorship concerns and partnership firms. It should be ensured that capital subsidy is not credited to capital account/(s) of proprietor/partners.
- ◆ For income-tax purposes (and not for accounting purposes), proportionate amount of capital subsidy is required to be reduced from written down value of the block of assets for calculating depreciation admissible under section 32 of the Income-tax Act, 1961, Verify from tax records that the amount is so reduced and report the same against clause No. 14(d) of Form No. 3CD.

Qn 8. Write short notes on the following :

[5 x 2 = 10]

- (a) Substantive Procedures
- (b) Audit Working Papers.

Ans. 8 (a) Substantive procedures (more specifically tests of details of transactions and balances *i.e.* vouching, postings, verification of assets and liabilities, comparing balance sheet and profit and loss account with ledger) directly target the amounts of transactions and balances which appear in the final accounts. Compliance procedures do not directly target the amounts of transactions and balances which appear in the final accounts. They target the controls.

If auditor's preliminary assessment of internal controls is that they are not effective or that performing compliance tests could not be efficient, he may altogether dispense with compliance procedures and perform only substantive procedures. Also, in a situation where both inherent risk and control risk are assessed as high, the auditor would omit compliance procedures and attempt to obtain evidence only through substantive procedures. However, auditor cannot omit to perform substantive procedures in any situation, no matter how strong the controls are. If controls are strong, he may perform substantive tests on lesser number of transactions but cannot omit substantive procedures altogether

Ans. 8 (b)

(a) Working papers should record :

- ◆ the audit plan;
 - ◆ the nature, timing and extent of auditing procedures performed; and
 - ◆ the conclusions drawn from the evidence obtained.
- (b) All significant matters which require the exercise of judgment, together with the auditor's conclusions thereon should be included in the working papers.
- (c) Working papers should be sufficiently detailed and complete for an auditor to obtain an overall understanding of the audit.
- (d) Working papers should be designed and properly organised to meet the circumstances of each audit and the auditor's needs in respect thereof.
- (e) The auditor should use standardized working papers (e.g. checklists, specimen letters, standard organisation of working papers).
- (f) Apart from the above points, the auditor should keep in view the following points in determining the form and content of working papers :
- ◆ the nature of the engagement;
 - ◆ the form of the auditor's report (e.g. in the context of companies, the auditor may like to keep working papers for each para of CARO, 2003);
 - ◆ the nature and complexity of the client's business;
 - ◆ the nature and condition of client's records and degree of reliance on internal controls. (If client's records are not properly maintained more detailed working papers may need to be maintained);
 - ◆ the need in particular circumstances for direction, supervision and review of work performed by his assistants; and
 - ◆ the requirements of AASs issued by ICAI compulsorily require auditors to document certain matters, [e.g. See AAS-6(Rev.), AAS-10(Rev.), AAS-34, etc.]