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**ISBN : 978-81-7666-806-4**

# **Solved SCANNER™ Appendix**

## **IPCC Gr. II Paper - 6 May - 2009**

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### **Solution of May 2009 Examination**

#### **Paper - 6 : Auditing and Assurance**

#### **Chapter - 2 : Basic Concepts in Auditing**

##### **2009 - May [1] (i)**

**False :** The principle of confidentiality is one of the basic principles of auditing. Auditor is generally not expected to disclose the information of his client to others. He can disclose the information to others only when (a) permitted by his client, or (b) as per any statutory obligation dictated by any law.

##### **2009 - May [3]**

Auditor checks specific assertions that the items of financial statements mislead and also gives his opinion in the form of overall assertion in respect of financial statements taken as a whole.

The specific assertions are -

- (a) Existence - That the asset or liability exists at a given date.
- (b) Occurrence - That a transaction or event has occurred which pertains to the entity
- (c) Rights and obligations - The asset is a right of the entity and the liability is an obligation of the entity at a given date.
- (d) Valuation - An asset or liability is recorded in the proper amount and recorded at appropriate carrying value.

- (e) Measurement - A transaction is recorded in the proper amount and revenue or expenses is allocated to proper period.
- (f) Completeness - There are no unrecorded asset/liabilities or transactions
- (g) Presentation - An item is disclosed, classified and described in accordance with accounting policies and legal requirements.

The overall assertion opined by the auditor about the financial statements are:

- (a) The profit and loss account give a true and fair view of the results - profit or loss for the period ended on the last date of the accounting period.
- (b) The balance sheet gives a true and fair view of the financial status or financial position of the entity as on the last date of the accounting period.

### **Chapter - 3 : Preparation for an Audit**

**2009 - May [1] (ii) (iii)**

- (ii) **False :** Auditing in depth does not mean the 100% vouching. It is checking selected transactions from beginning to end to understand the entire system within which the transaction passes through.
- (iii) **False :** If it is possible for auditor to check the transaction by himself through direct access, it is not fair for him to merely rely the management representation as prime audit evidence.

**2009 - May [8] (b) (c)**

#### **(b) Letter of weakness**

- (1) When he comes across any weakness in the control points, he issues letter of weakness.
- (2) 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.
- (3) Lapses in operation of internal control too are reported in the communication of weakness.
- (4) 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.
- (5) 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 is should not be taken to be review and comment on adequacy of the control mechanism for management purpose.

#### **(c) Knowledge of client's business - Auditor can obtain this information from:**

- (i) Clients annual report to shareholders
- (ii) Minutes of shareholders/board of directors

- (iii) Internal financial management reports of current & previous year
- (iv) Previous year audit working papers
- (v) Discussion with client
- (vi) Clients policy and procedure manual
- (vii) Publications like trade journals, magazines, news papers and
- (viii) Visit to clients premises

**Chapter - 4 : Internal Control (Including EDP Environment)****2009 - May [5] (a)**

Internal control points for collection of tuition fees :

- (i) College must have a clear cut tuition fee structure which is approved by the college council.
- (ii) The challan or paying in slip should contain necessary fields for identifying the roll number of the student, class, and period for which fees is paid etc. The slips should have such number of counterfoils to cross check the remittance.
- (iii) The paying in slip when filled by the students, should be checked for its correctness as to applicable amount etc by one clerk and the amount should be entered in a scroll. He must sign the slip which authorises the cashier to accept the fees as per slip.
- (iv) The cashier scroll and the authorising officer/s scroll should be checked by an officer daily.
- (v) All remittance should be banked each day. No amount should be allowed to be spared for meeting any type of expense.
- (vi) Alternatively, the fees may be directly remitted into bank and banker's daily remittance slip should be scrutinised by college officers. Arrears list should be periodically prepared from the students rolls. Any concession, remission of tuition fees should have approval of competent authority. Delayed remittance should carry fines or compensating charges for delay. When students are readmitted after removal for non-payment of fees, the admission should carry the permission of competent authority.

**Chapter - 6 : Audit of Payments****2009 - May [7] (a)****Production incentive paid to workers, auditor should :**

1. Trace the total production incentive paid to workers from P&L Account to prime records/division wise/dept wise records.
2. Get the details of incentive scheme from the management and see that it is approved and updated by a competent authority.
3. Check the production figures from independent source and should correlate them with the incentive payment working computed by the accounts department.

4. Check list of payment and also acquitted disbursement slips of select departments/periods for scrutiny of various data generated in the fields for their accuracy and completeness.
5. Make an overall analytical procedure of ensuring the expense booked is commensurate in quantum with statistical data on production and strength of workers.

**Chapter - 8 : Verification of Bank Balance and Cash-in-hand****2009 - May [4] (a)**

The scope of audit may be limited for various reasons, (i) the entity may impose restriction on scope of audit, (ii) the limitation may be imposed by circumstances.

- (i) When the audit is carried out under and as per statute, the auditor should not accept the assignment when his duties are curtailed by agreement, unless required by any Law.
- (ii) When audit is carried out in accordance with the entity's terms voluntarily, the auditor may indicate his scope in his audit report.

In some cases, the circumstances may impose restrictions on audit scope. e.g. when the auditor is appointed after the year end, he may not be able to participate in stock verification. Or sometimes, the records required may not be available so that the auditor may not be able to check details in the manner he liked. Such limitations in scope may warrant an auditor to express disclaimer of opinion or qualified opinion in his audit report depending upon the circumstances.

The non co-operation of ABC Limited will amount to limitation on scope of auditors.

**Chapter - 9 : Audit of Trading Transactions and Purchases****2009 - May [4] (b)**

**Manipulation of Accounts :-** Accounts are falsified in order to conceal the true position of the business for some purpose. They are always intentional, for a predetermined purpose and are generally committed either by the owners or top management personnel or senior officers of the business. This type of fraud is generally committed :

- (i) to avoid incidence of income-tax or other taxes by showing profits at a lower figure.
- (ii) to withhold declaration of dividend even there is adequate profit.
- (iii) for receiving higher remuneration where managerial remuneration is payable by reference to profits.
- (iv) for delaying a dividend when there are insufficient profits by showing profits at inflated figures.

Such types of frauds are difficult to be detected as they are committed by persons holding position of trust and use carefully guarded by them. Such frauds are generally of the following nature:

- (i) Recording fictitious purchases or suppression of purchases
- (ii) Recording fictitious sales or omission of sales
- (iii) Recording fictitious expenses or omission of expenses
- (iv) Over valuation or under valuation of stock.
- (v) Taking credit for accrued income not likely to be received or omission of income.
- (vi) Revenue expenses changed to capital and vice-versa. AAS 4 (new SA 240) 'Auditor's Responsibility to consider fraud and Error in an Audit of Financial Statements' deals with the auditor's responsibilities for the detection of material misstatement resulting from fraud and error. It requires a considerable skill and vigilance on the part of an auditor. In doubtful cases he may refuse to believe the information supplied to him by any officer of the concern.

An auditor who uses adequate skill and reasonable care, is legally exempt from liability if he fails to discover a well concealed detection. But an auditor by a skilled auditor should rarely permit such a failure.

All possible opportunities for dishonesty and manipulation of the accounts must be considered and guarded against and the degree of checking and investigation should be determined by the circumstances surrounding the transactions and the effectiveness of the system of intended check in operation.

#### **Chapter - 11 : Audit of Ledgers and other Transactions**

##### **2009 - May [2] (b)**

- (i) According to Section 209 of the Companies Act, 1956 books are to be maintained on accrual basis. Accrual method of accounting is also a fundamental assumption of accounting policies.
- (ii) When the interest becomes due for payment only at maturity date, it accrues each quarter. Interest accrued but not due should be shown under current assets in the balance sheet as per Schedule VI Part I requirement.
- (iii) As such, the profits and current assets are understated and true and fair view of the accounts are thus violated.
- (iv) On considerations of materiality of the item, the auditor can appropriately decide to qualify the audit report.

##### **2009 - May [7] (c)**

#### **Bad debts**

1. Major amount of bad debts in the schedule be taken for scrutiny.
2. The amount of bad debts should be traced to the schedule of bad debts written off during the year.

3. The bad debts should be properly disclosed in P&L account according to its materiality.
4. Check that the amount considered in write off had been overdue for long and scrutinize the correspondence files.
5. Check the authority for write off and the level of authority is sufficient higher than the executive involved in collection.
6. If provision had already been created for bad debts, see that to the extent of actual bad debts written off, the provision is released.

**Chapter - 13 : Depreciation and Reserves****2009 - May [7] (OR) (c)****Proposed dividend**

1. Proposed dividend is to be provided for even though it is proposed and is to be declared after the end of the accounting period in terms of AS 4 and also schedule VI disclosure requirements.
2. The auditor should check the amount of paid up share capital and verify the quantum of dividend proposed by checking the calculations.
3. The auditor should check the minutes of the Board for the amount of dividend proposed to be considered for its declaration in general meeting.
4. Dividend tax payable on proposed dividend should be provided for.
5. The interim dividend if any paid should be checked and ascertained that the proposed dividend is properly computed by adjustment to it, if the same had been reckoned for the total dividend.
6. The account should be properly disclosed in P&L account and also in balance sheet according to the requirements of schedule VI to the Companies Act 1956.

**Chapter - 14 : Verification of Assets****2009 - May [1] (x)**

- (x) **False** : They are shown under current assets, loans and advances under sub head bank balances as per Schedule VI part I requirement.

**2009 - May [6] (b)**

The Auditor while considering advances granted by bank for purchase of machinery has to consider valuation report given by civil engineer to the bank. AAS 9 (new SA620) clearly states while reliance on work done by expert, the auditor should consider :

- (i) Professional qualification of experts
- (ii) Experience and reputations.

When the auditor finds that civil engineer can not be considered expert for valuation of machinery, he should insert on other analytical procedures to confirm value of machinery. Even after this, if he is not satisfied, he should give qualified opinion.

**2009 - May [7] (b)**

**Goods lying with third party, auditor should :**

1. Check that the materiality of the item under this caption included in stocks.
2. Obtain confirmation of the amount of goods lying with them. The confirmation may be directly obtained by auditor or be produced by client depending upon the situation.
3. Inquire into the necessity of sub contractor retaining the stock. He should ensure the process that they do are related to the business requirement and there is no ground for suspicion on this score.
4. The records, voucher/slips for the regulating the movement of stock into and out of entity for sub-contracting work be reviewed by vouching for few transaction for ensuring existence and working of internal control system for them.
5. The goods lying with them for the very long period would merit auditors' special attention for making provision.
6. The excise gate pass, entry in such records, information in returns, be also cross-verified.
7. The valuation of stocks should be correctly made for including material cost on appropriate stock valuation formulae and also for inclusion of proportionate processing charges for the work in process with the contractors.
8. The provision should be created for work done, billed for processing and also for incidence of any applicable levy like service tax payable.

**2009 - May [8] (a)**

Attendance at stock taking

1. The physical verification of stock is the responsibility of the management. The auditor may find it appropriate to attend the stock taking, if the inventory value is material in his opinion.
2. The extent of participation in inventory taking depends upon the internal control system prevailing, results of examination of inventory records and analytical review procedures.
3. When auditor attend inventory taking, he ensure that the instructions given for inventory taking is followed.
4. Auditor should test checks few items by himself for their existence and quantum. He selects to test high value items importantly.
5. The physical conditions of stock - like its age, deterioration, obsolescence etc., are looked into by auditor.
6. The auditor reviews stores records and notes down major discrepancies for reconciling them in a subsequent date.

7. The cut off arrangement is also looked into ensure that the entity accounts for stock for which liability had been booked and excludes stock which had been sold.

**Chapter - 15 : Verification of Liabilities****2009 - May [1] (ix)**

- (ix) **False** : Contingent liabilities existing on the balance sheet date are disclosed by way of note and not provided for even if it had crystallized subsequently.

**Chapter - 16 : Other Verifications****2009 - May [6] (a)**

Auditor's duty regarding A Ltd. are as follows :

- (a) Subsequent events means events occurred after balance sheet date but before the date of audit report.
- (b) In case of audit of components, such as branch or division the subsequent events are events after the balance sheet date and before the date of audit report of that component.
- (c) The subsequent events, according to AS 4 and as reproduced in AAS 19 (New SA 560) are of two types - (a) those which provide further evidence of conditions that existed at the balance sheet date and (b) those which are indicative of conditions that arose subsequent to the balance sheet date.
- (d) Depending upon the type of subsequent events, the auditor should decide on adjustment of accounts based on evidential value gathered for conditions that existed as on the date of balance sheet date or disclosure of the conditions that arose subsequent to the date of balance sheet.
- (e) The auditor should perform audit procedures to identify the subsequent events that are relevant for adjustment/disclosure. These procedures would include reading minutes of Board subsequent to accounting period, contacting lawyers for knowing progress of pending Cases, inquiry with the company management, scrutinizing subsequent interim accounts etc.
- (f) The auditor should perform these procedures as near as practicable to the date of his audit report.
- (g) If the management does not account for the subsequent events in the financial statements where they are to be accounted, the auditor should appropriately comment his report by a qualification or disclaimer.



**Chapter - 17 : Company Auditor****2009 - May [1]**

- (iv) **False :** The auditor's appointment by special resolution is required in cases of companies in which not less than 25% of subscribed capital and not less than 25% of authorised capital is held by public financial institutions.

**2009 - May [2] (c)**

- The first auditor appointment by the Board holds the office till the conclusion of the first annual general meeting.
- When P, the first auditor resign, the board of directors has still power to appoint Mr. Q as auditor till conclusion of first annual general meeting.
- The company at the AGM may remove auditor so appointed and appoint another auditor.

**2009 - May [8] (OR) (c)****Responsibilities of joint Auditors**

AAS 12 (new SA 299) on Responsibilities of Joint Auditors require that joint auditors should by mutual discussion divide the audit work among themselves. It further states that each joint auditor is responsible only for the work allocated to him, whether or not he has prepared separate report on the work performed by him.

Otherwise, all joint auditors are jointly and severally responsible :

- (1) 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;
- (2) In respect of decision taken by all joint auditors concerning the nature, timing or extend of the audit procedures to be performed by any of the joint auditors;
- (3) In respect of the work which is not divided among joint auditors and is carried out by all of them;
- (4) For ensuring that the audit report complies with requirements of the statute.
- (5) For examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute.

**Chapter - 18 : Powers & Duties of Auditors, Audit Report and various Audits****2009 - May [1] (v) (xii)**

- (v) **False :** According to AAS 22 (new SA 510) "Initial Engagement"-opening balance, it is the duty of the auditor to verify and obtain appropriate evidence in respect of opening balances brought forward from the preceding period.

- (xii) **False** : Disclaimer of opinion is issued when the auditor is unable to frame an opinion in view of certain reasons such as non-availability of information, non-performance of procedure, lack of clarity in information etc. Where the auditor is positively in disagreement with management on certain issue he would issue qualified report.

**2009 - May [2] (a)**

- (i) It is permissible for the business entity to charge depreciation on its assets at rate different from schedule XIV rates provided those rates are higher than the schedule rates based on technical estimation or otherwise allowed under Section 205 of the Act.
- (ii) If the rates adopted are different from the principal rates specified in the schedule, the same need to be disclosed in the notes to the accounting.
- (iii) If there is a non-disclosure of rates, then it is a violation of AS-1 which requires the accounting policies to be disclosed in the accounts and also schedule XIV requirement which too requires such disclosure.
- (iv) The auditor hence, is right in his approach to qualify the same in his report.
- (v) The materiality of an item is not always measured in terms of quantitative factors alone.
- (vi) The qualitative factors also effect the judgment of auditors in opining the true and fair view of accounts.
- (vii) The contention of the management that it does not meddle with the profit is not founded.
- (viii) When the management does not correct the situation, the auditor is justified in qualifying his audit report.

**Chapter - 19 : The Company Audit**

**2009 - May [5] (b)**

Annexure to Audit Report includes matters specified in Paragraphs 4 and 5 of the CARO, 2003.

- (i) The company has maintained proper records showing full particulars including quantitative details of fixed assets.
- (ii) All the assets have been physically verified by the management at regular intervals. No material discrepancies were noticed on such verification.
- (iii) If company has disposed off substantial part of plant and machinery the sales of such plant and machinery has not affected going concern status of the company.

**Chapter - 23 : AAS, AS and Guidance Notes**

**2009 - May [1]** (vi) (vii) (viii) (xi)

- (vi) **True :** As per AAS 25 (new SA 710) “Comparatives” with reference to financial statement presentation includes the corresponding previous year figures and are intended to be read on relation to the amounts and other disclosures relating to the current period.
- (vii) **False :** AS 10 “ Accounting for Fixed Assets” states that this Accounting Standard is not applicable to wasting assets like quarries, minerals oil and natural gas.
- (viii) **True :** As per AS 12 “Accounting for Government Grants” when Government grants in the form of non-monetary assets such as land, plant and equipments etc. are received free of costs then such assets should be entered in the books of account at nominal value.
- (xi) **False :** Branch auditor is not a joint auditor within the meaning of AAS 12 (New SA 299). He is another auditor within the meaning of AAS 10 (New SA 600).

**Question Paper of November 2009 Examination**

**Paper - 6 : Auditing and Assurance**

**Chapter-1 : Nature of Auditing**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (iv) The auditor, in the interest of the users, while explaining the nature of his reservation, can describe the work of the expert with his name in the audit report without obtaining prior consent of the expert.

(2 marks)

**2009 - Nov [3]** Discuss the basic principles governing an audit. (10 marks)

**Chapter-3 : Preparation for an Audit**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (i) While auditing the accounts of a company, it is obligatory that the auditor must adopt sampling technique. (2 marks)
- (v) The auditee firm has no right to compel the auditor to provide copies of the working papers. (2 marks)
- (x) Analytical procedures are unable to help the Auditor in determining the nature, timing and extent of other audit procedures at the planning stage. (2 marks)

**2009 - Nov [4]** (a) Explain concept of materiality and factors which act as guiding factors to this concept. (6 marks)

- (b) Describe a set of instructions, which an auditor has to give to his client before the start of actual audit. (4 marks)

**2009 - Nov [8]** (a) X, a Chartered Accountant was engaged by PQR & Co. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement.

Offer your comments in this regard. (5 marks)

**2009 - Nov [8] (OR)** Write short notes on the following :

- (b) Audit risk at the account balance level and at the class of transactions level. (5 marks)

**Chapter-4 : Internal Control (Including EDP Environment)**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (xii) The overall objective of audit changes in Computer Information System (CIS) environment. (2 marks)

**Chapter-6 : Audit of Payments**

**2009 - Nov [2]** Comment on the following situations :

- (a) XYZ Ltd. Co. gave a donation of Rs. 50,000 each to a Charitable Society running a school and a trust set up for the service of Blinds during financial year ending on 31<sup>st</sup> March, 2009. The average net profits of the company for the last three years were 15 lakhs. (8 marks)
- (b) Mr. X, a shareholders of the company pointed out that :
- (ii) Premium received on issue of shares prior to the date of balance sheet has been transferred to Profit and Loss account for arriving at the figure of commission payable to the managing director. (6 marks)

**Chapter-8 : Verification of Bank Balance and Cash-in-hand**

**2009 - Nov [7] (OR)** Comment on the following situation :

- (c) Bank overdraft. (5 marks)

**Chapter-10 : Audit of Sales**

**2009 - Nov [7] (OR)** How would you vouch/verify the following .

- (b) Goods sent out on Sale or Return Basis. (5 marks)

**Chapter-11 : Audit of Ledgers and other Transactions**

**2009 - Nov [8] (b)** Cut-off arrangements (5 marks)

**Chapter-13 : Depreciation and Reserves**

**2009 - Nov [6] (b)** As an auditor comment on the following situation :

MNR Co. Ltd. did not provide for depreciation during the financial year 2007-08 due to inadequacy of profits. The company declared dividend during the financial year 2008-09 without providing for the previous year's depreciation. (5 marks)

**Chapter-14 : Verification of Assets**

**2009 - Nov [2] (b)** Mr. X, a shareholders of the company pointed out that :

- (i) The goodwill in the Balance Sheet of the company has appeared on same figure during the past three years. (6 marks)

**2009 - Nov [7]** How would you vouch/verify the following .

- (b) Leasehold property. (5 marks)

**Chapter-17 : Company Auditor**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (viii) Mr. X, a Chartered Accountant, is an employee of M/s M & N Co., a firm of Chartered Accountants of India. The firm is the Auditors of ABC & Co. Ltd. After auditing the accounts of the Company the Auditor firm allowed Mr. X, their employee, to sign the audit report; which he did. (2 marks)

**2009 - Nov [2]** (c) A, B & C Company Ltd. removed its first Auditor before the expiry of his term without obtaining approval of the Central Government.  
(6 marks)

**2009 - Nov [7]** (a) Comment on the following situation :  
XYZ Co. Ltd. reappointed A and B as their joint auditors in the Annual General Meeting. The AGM authorised the Board of fillup the vacancy at their own in the event of both or either of auditors declined to accept the assignment. The Board passed a resolution to appoint C if any of the auditors declined to accept the assignment.  
B declined to accept the assignment and Board of Directors appointed C in place of B as per its resolution.  
(5 marks)

**Chapter-18 : Powers & Duties of Auditors, Audit Report and Various Audits**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (ix) The Auditor disagreed with the management with regard to the acceptability of the Accounting Policies and the inadequacy of disclosures in the financial statements and issued a disclaimer.  
(2 marks)

**Chapter-19 : The Company Audit**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (ii) Interim dividend is not a part of dividend. (2 marks)  
(iii) A casual vacancy caused by resignation of the auditor can be filled by the Board of Directors. (2 marks)  
(vii) Provisions of Companies (Auditor's Report) order 2003 as amended upto date, apply to clubs, chambers of commerce, research institutes etc. which have been established under Section 25 of the Companies Act, 1956. (2 marks)

**2009 - Nov [6]** (a) State clearly provisions of the Companies Act, 1956 with regard to issue of shares at a discount. (5 marks)

**Chapter-20 : Government Audit and Audit of Local Bodies**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (vi) Comptroller and Auditor General of India can be removed by the Prime Minister of India on the recommendation of his Council of Ministers. (2 marks)

**2009 - Nov [8] (OR)** Write short notes on the following :

- (c) Powers of C & A.G. in connection with the performance of his duties.  
(5 marks)

**Chapter-22 : Miscellaneous Audits**

**2009 - Nov [5]** (a) What are the six important points that will attract your attention in the case of audit of a Hotel ? (5 marks)

**Chapter-23 : AAS, AS and Guidance Notes**

**2009 - Nov [1]** State with reasons (in short) whether the following statements are true or false.

- (xi) A Company which has been unable to negotiate borrowings from its bankers claims that it will be able to continue as a 'going concern'. (2 marks)

**2009 - Nov [5]** (b) State the informations to be disclosed in the financial statements according to the requirements of A.S.-6. (5 marks)

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