

PAPER – 2 : AUDITING

Answer Question Nos. 1 and 2 and any four questions from the rest.

Question 1

As on Auditor, comment on the following:

- (a) Sri Limited is a manufacturing company engaged in manufacture of cement. It had three plants already commissioned in its site at Chennai. The company expanded its plant capacity by contracting with a supplier for the purchase and installation of one additional plant. The project was commenced on 1.7.2007 and the new plant commenced commercial operations on 1.1.2008. The new plant was capitalized and shown as Fixed asset as on 31.3.2008 at cost which included, besides other things, the following:
- (a) Contract price of plant and equipment and installation costs
 - (b) Interest due for the period till 31.3.2008 for the term loan taken from scheduled bank for financing the project which is repayable over five years commencing from 1.7.2008.
 - (c) Salaries, welfare expenses of the plant engineers of the company for the period from 1.7.2007 to 31.12.2007 who supervised the contract work. (5 Marks)
- (b) The Investments of ABC Limited includes 5,000 equity shares of Rs. 100 each in Amudhan Bank Limited. Amudhan Bank Ltd. declared 20% dividend for the year ended 31.3.2007 at its General Meeting held on 30.6.2007. ABC Limited finalised its accounts for the year ended 31.3.2007 on 30.8.2007 and it includes Rs. 1,00,000 being the amount of dividend received by it from Amudhan Bank Ltd. in its other income subsequent to its Balance Sheet date before approval by the Board of Directors. (5 Marks)
- (c) The management of Ankita Limited suggested for quick completion of the statutory audit that it would give its representation about the receivables in terms of their recoverability. The management also acknowledged to the auditors that the management would give their representation after scrutinizing all accounts diligently and they own responsibility for any errors in these respects. It wanted auditors to complete the audit checking all other important areas except receivables. The auditor certified the account clearly indicating in his report the fact of reliance he placed on representation of the management. (4 Marks)
- (d) AS Limited purchased on 1.4.2007 a machinery from a foreign country at a price of \$ 1, 50,000 upon terms of credit that the price should be settled within six months from the date of purchase. The company capitalised the Asset and created Liability for the capital goods converting the foreign currency liability to Indian Rupees at a rate of exchange prevailing as on 1.4.2007. When the company settled the liability on 18.7.2007, it had to

incur an additional amount of Rs. 6, 75,000 due to change in foreign exchange rate on the date of settlement. It added this additional amount of exchange variation in the capital cost of the asset and charged depreciation upon the enhanced amount of asset value from 18.7.2007. (4 Marks)

Answer

- (a) Accounting for Fixed Assets and Borrowing Cost : According to AS 10, the cost of fixed asset includes all expenses for bringing into existence and working condition the asset for its intended purpose. Accordingly all expenses attributable to the construction of fourth cement plant can be added to the cost except those which had been not permitted by the AS.

The cost of purchase, installation of asset is directly related to bringing the asset into the working condition for intended use and hence is correctly capitalized.

According to AS 16 on borrowing cost, the interest expenditure on borrowing can be capitalized till the date of the cessation of construction. The capitalization ceases when substantially all activities of construction are completed. Simply, the interest can be capitalized till the completion of the project and it should not be capitalized after commencement. In the instant case of capitalization of interest, the company is partly right in capitalizing it till 31.12.2007 and is wrong for capitalizing it beyond 31.12.2007 till 31.3.2008.

The allocation of common overhead is allowed if it they are specifically relatable to project. The salary expenditure of plant engineers may be capitalized for the construction period.

Accordingly, the auditor shall qualify his report for the deviation if not adjusted, taking into account the materiality of the impact on accounts.

- (b) Dividend Recognition : ABC Limited accounted the dividend income from its investment in Amudhan bank Limited declared subsequent to its (ABC Limited) balance sheet but before finalization of the accounts.

According to AS 9 on revenue recognition, the dividend income is recognized when the right to receive it occurs viz. the date of declaration.

As such, the date of declaration is the relevant date. The date of declaration being 30.6.2007 falls after the end of the accounting period.

Hence, the company is wrong in accounting an income which does not pertain to the year under reference. This may warrant a qualification in the audit report subject to materiality consideration.

- (c) Management Representation : The management of Ankita Limited wants the auditor to carry out audit on all areas except on area of receivables. There cannot be any restriction on scope of audit in case of statutory audit.

The management representation, according to AAS 11, cannot substitute other audit evidence that the auditor could reasonably expect to be available to the auditor.

The audit evidences available for checking receivables- say, invoices, debt acknowledgement documents, receipts, statement of accounts, confirmations etc., are available evidences which auditor is duty bound to verify.

Just because management had owned responsibility for the correctness of its evaluation of receivables, the auditor cannot shirk his responsibility. This is negligence on his part if he relies on the management representation without assessing the corroborative available evidences.

- (d) Effects of Changes in Foreign Exchange rates: According to AS 11, the foreign currency transactions should be initially recognized at the exchange rate prevailing on the date of transaction. Accordingly, the asset and liability should be accounted at exchange rate prevailing on the date of purchase.

The monetary items should be reported at the exchange rate prevailing on the close of the accounting period. The liability for capital goods purchased is a monetary item.

If during the accounting period, if a monetary liability is settled at a rate different from the rate at which it was initially recognized the exchange difference should be charged to P&L account in the year of settlement.

According to AS 11 (revised), hence, it is necessary to write off Rs, 6.75 lakhs being exchange differences at the date of settlement. It cannot be added to the cost of the capital. Hence, the company is wrong in capitalizing foreign exchange differences between the amounts of initial recognition and settlement and computing depreciation on the wrongly capitalized portion of the asset.

This warrants correction by the company. Else, the auditor may qualify his report upon relevant considerations.

Question 2

Comment on the following:

- (a) AAS Company Limited with its registered office at Chennai has two branch offices located at Mumbai and Kolkata. The accounting transactions of the branches are recorded and the accounting records are maintained in the branches themselves. Only quarterly summarized Trial balance, Profit and Loss account and Balance Sheet are sent to Chennai office by the branch Accountants. One of the assistants of your audit team raises an issue that the company is required to maintain its books and records at the registered office; the company, keeping its accounting records at the branches, hence is as default of not maintaining proper books at registered office as per the Company law provisions. (5 Marks)

- (b) During the year 2007-08, it was decided for the first time that the accounts of the branch office of AAS Company Limited be audited by qualified Chartered Accountants other than the company auditor. Accordingly, the Board had appointed branch auditors for the ensuing year. One of the shareholders complained to the Central Government that the appointments was not valid as the Board of Directors do not have power to appoint auditors, be they Company Auditor or Branch Auditors? (4 Marks)
- (c) The Chief Accountant of AAS Company Limited says that the company, being in loss, would not provide depreciation for the Fixed Assets during this year, it would provide for the arrears of depreciation when it has profits in the future years; there is nothing wrong in this treatment, as according to the Companies Act, 1956, the company is bound to provide for depreciation only when it intends to declare dividend; in the present case, the company does not declare dividend. (4 Marks)
- (d) Other liabilities in Balance Sheet of AAS Limited include Rs. 7.8 lakhs being the amount of excise duty payable since 1.5.2007 remaining unpaid till 31.3.08. However, the same had been paid by the company on 15.4.2008 upon getting clarification from its advocates that the liability is actually payable by it. (5 Marks)

Answer

- (a) Maintenance of Books at Branch: According to section 227 of the Companies Act, 1956, the auditor has to report whether the company has maintained proper books of account. According to section 209 of the Companies Act, the company has to keep at its registered office all the accounting records specified therein.

As regards, the records of the branch, section 209 permits that the same may be maintained at branches provided summarized returns of the branch are sent to registered office at such frequent intervals not less than a quarter.

In the present case, since the branches are sending quarterly summarized returns of accounting details, it is deemed that proper books of accounts are maintained at registered office.

Hence, the contention of the audit assistant is misplaced. There is no statutory violation committed by the company.

It may be noted, still the company auditor has right of access (at registered office itself by calling for records) and right to visit the branch.

- (b) Appointment of Branch Auditor: Under section 228 of the Companies Act, 1956, the accounts of the branch may be audited by the company auditor or by a separate branch auditor/s, unless where there is branch audit exemption. When it had been decided that the accounts of the branch may be audited by a person other than company auditor, the shareholders in general meeting should appoint branch auditor. The shareholders in

general meeting, instead of appointing branch auditor, may authorize the board of directors to appoint branch auditors.

In the present case, the board has appointed branch auditors without obtaining authorization from the shareholders in general meeting. The board had appointed the auditor where it did not have authority to do so. As such, the appointment is invalid. The shareholder's complaint is right.

The branch auditor should ascertain before accepting the audit whether his appointment is valid.

- (c) Non provision of depreciation : According to section 205 of the Companies Act, 1956, the company cannot declare dividend unless it provided for depreciation. But the true and fair view of the results of the company must be reflected in the accounts as per section 211 of the Companies Act. Generally Accepted Accounting Principles require the depreciation to be charged for fixed assets so that the revenue matched with the cost of expiration.

The Accountant's view of looking at depreciation as a mere legal requirement for declaration of dividend is partial appreciation of the accounting reality. According to Schedule VI of the Act, the profit and loss account shall separately disclose depreciation. If no provision is made for depreciation, the same should be disclosed by way of note.

Accordingly, if the company persists in not providing the depreciation, the same should be disclosed. Again, the non-provision will be subject of qualification in the auditor's report even if it has been disclosed in notes.

- (d) Undisputed Statutory Liability : According to CARO 2003, if any undisputed statutory due like excise duty, income tax etc, is not remitted within due date and is outstanding for more than six months, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the present case, the statutory liability has crystallized and is outstanding for more than six months. It is not a disputed liability. It is an undisputed liability about which the company had some doubts.

The fact that it had been since remitted before finalization of accounts would not render the requirement of disclosure in CARO 2003 report. The fact of subsequent remittance may be added after the disclosure of non-remittance in the CARO 2003 report.

Question 3

- (a) (i) What is an Audit Engagement letter? (2 Marks)
- (ii) Discuss the situations where it is necessary to issue audit engagement letter each year for repetitive audits. (6 Marks)

- (b) In a system based audit, test checking approach provides a good base for the auditor to form his opinion on the Financial statement. Give your comments. (8 Marks)

Answer

- (a) (i) Audit engagement letter : Audit engagement letter is a communication issued by auditor to the auditee (the client) expressing therein inter alia, the fact of acceptance of his audit engagement, the objectives and scope of his audit, the extent of auditor's responsibilities and management responsibility for compilation of accounting, application of accounting principles, standards, fees.
- (ii) Need for the Issue of Audit Engagement Letter: It is not necessary to issue audit engagement letter each year for repetitive audit. It is enough if the same had been issued at the time of taking initial engagement.

When it is repetitively issued : However, the auditor may think of issuing a fresh engagement letter in one or more circumstances described below :

- (i) When it appears that the client has misunderstood the objective and scope of audit.
- (ii) Where there has been change in management, board, or ownership so that it is felt that it is pertinent to remind them of the engagement terms again.
- (iii) Where any revision by way of addition, deletion, or modifications had been contemplated in the engagement letter originally issued.
- (iv) Where significant changes had occurred in nature, volume of the business transactions of the client which warrant the scope and terms of engagement to be altered to be in tune with them.
- (v) Where there has been necessity to modify audit approach to be in line with the pronouncements of ICAI, the Companies Act and the like.
- (b) Test Checking in System Based Audit : System-based audit is done by evaluating the accounting system and internal control and ascertaining their reliability through audit tests. Depending upon the size and nature of the business concerned, an accounting system will incorporate necessary internal control to provide assurance that:
- (i) All the transactions and information have been recorded,
- (ii) Fraud and errors, if any, in preparing the accounts will be identified,
- (iii) All the assets and liabilities recorded in the books of account do exist and are shown at correct amounts,
- (iv) There is compliance with statutory regulations.

After the auditor has ascertained the client's accounting system, he should assess it to satisfy the above-mentioned requirements. The auditor, therefore, after evaluating internal control system, tests the same to ascertain whether it is actually in operation. For this purpose, he resorts to actual testing of the system in operation. This he does on a

selective basis, i.e., he adopts test checking technique. He plans this testing in such a manner that all the important areas stated above are covered. The test checking is done by application of procedural test and/or by auditing in depth. This approach is adopted in system based audit which is the modern audit approach. The system-based audit approach begins by evaluating the accounting system and internal control and then by testing them to ascertain their reliability. By this, the auditor first establishes how reliable the system is and then decides how much detailed checking of the transactions and verification of assets and liabilities he must undertake. If the system is found to be good, the detailed checking could be curtailed, but if system is weak, more detailed checking would be necessary. However, checking cannot be completely eliminated; it can only be scaled down if state of the system is satisfactory. In case the initial evaluation itself shows weaknesses, extensive checking should invariably be undertaken.

Question 4

How will you vouch/verify the following?

- (a) Liability towards gratuity
- (b) Expenditure incurred for promotion of a product
- (c) Balances with excise authority
- (d) Receipt of special backward area subsidy from Government. (4 X 4 = 16 Marks)

Answer

- (a) Liability towards gratuity:
 1. The liability towards gratuity payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service, it is an ascertained present liability accruing over the period of service but payable upon cessation of service.
 2. The auditor should check the quantification of the gratuity liability. He should ascertain whether the same had been actuarially determined.
 3. The auditor should treat the actuary as an expert and conduct procedures relevant to checking the opinion of an expert in accordance with AAS 9.
 4. The auditor should check the technical competence of actuary, the input fed to the actuary, the assumptions made by the actuary, the methodology adopted by the actuary, opinion given etc.
 5. The auditor should bear in mind the relevant pronouncements of AS 15 "Employee benefits" in this regard. He should check whether the expenses of provision for gratuity are towards a defined benefit plan or contribution plan.
 6. If the contributions are made to outside agency, say the insurance company, he should check the premium paid, the acknowledgement receipts issued by the

insurance company, the coverage of policy etc. Premium due but not paid, prepaid premium etc should be appropriately accounted.

7. If the company maintains its trust for gratuity, the auditor may peruse whether the trust is an approved one under income tax law, whether the trust accounts are audited, copy of the latest accounts etc.
8. The contribution should be appropriately disclosed in the accounts as per Schedule V1 to the companies Act, 1956.

(b) Expenditure incurred for promotion of a product :

1. The expenditure incurred for promotion of a new or existing product may entail future benefits. It may be like advertisement in the papers, television, sales exhibition, participation in trade fair, issue of promotional pamphlets, free gifts etc.
2. The auditor should vouch the authority and accuracy of the transactions. He should read the contract with advertisement agencies, promotional policies decided by the management from the board minutes etc.
3. He should check the amounts paid to the agencies from bank book. He should check the accuracy, he should ascertain whether tax had been deducted in accordance with the tax law provisions if any applicable in this regard.
4. He should check whether the unpaid amounts and accrued liability towards promotional advertisement contracts had been duly provided for in the accounts.
5. The provision for fringe benefit tax in regard to sales promotion expenditure must be ascertained.
6. The huge expenditure should not be treated as deferred revenue expenditure. According to AS 26, these are not intangible assets that may be carried over the periods of accounting. These must be expensed with in the year in which these arise.

(c) Balance with excise authority:

1. The balance with excise authority in PLA account should be checked with the statements of accounts/records kept with excise section of the unit.
2. The remittance into the account, the utilization out of it etc should be cross checked with bank book, clearance forms etc.
3. The balance confirmation may be checked.
4. The balance should be shown under current assets and advances in balance sheet.
5. It is to be ensured that the balances in PLA is used only to the extent of liability after adjusting cenvat credit where available.

(d) Receipt of special backward area subsidy from Government :

1. The claim for backward area subsidy submitted to the authorities should be studied.

2. It should be ascertained whether the grant is of a capital nature for funding assets or of a revenue nature. Mere computation formula of quantum of grant with reference to the cost of project of itself will not make the grant a capital nature ispo facto.
3. The accounting of grant should be in accordance with AS 12 "Accounting for Government Grants" of ICAI. The revenue grant can be taken to income statement, with appropriate disclosure.
4. The capital grant may be adjusted against cost of asset or may be kept in a capital reserve to be transferred to Profit and loss account each year in proportion to depreciation of that asset charged in profit and loss account.
5. The receipt of the grant should be checked with bank statement, remittance challan etc.
6. The conditions attached to grant should be fulfilled by the company. The auditor should check whether any liability or refund of grant for breach of conditions could arise.

Question 5

- (a) State, how the reliability of audit evidence gets affected by the types of Audit evidences. (8 Marks)
- (b) Explain the compliance procedure and also substantial procedures as Audit methods of collecting evidences for forming an audit opinion. (8 Marks)

Answer

- (a) Reliability of audit evidences and types of audit evidences : The audit evidences provide credence to the assertions that a transaction seeks to reveal out. Depending upon the sources, forms or nature of audit evidences, the credence or reliability value of the evidences may vary. Generally
 1. The external evidence is usually more reliable than internal evidence. (Source)
 2. Internal evidence is more reliable when related internal control is satisfactory. (Nature)
 3. Evidence in the form of document or written representation is usually more reliable than oral representation. (Form)
 4. Evidence obtained by the auditor himself is more reliable than the evidence obtained through the entity. (Nature)
- (b) Collection of evidences to form audit opinion : Auditor should obtain sufficient and appropriate audit evidences and test them before framing an opinion about the assertions the financial statements reveal. For this, the auditor checks evidences through (a) Compliance procedure and (b) Substantial procedure.

Compliance procedures are tests designed to obtain reasonable assurance that those internal control on which audit reliance is to be placed are in effect. It seeks to test that (a) there exists internal control, (b) the existing internal control is effective and (c) the internal control is working without break or lacunae during the period under review.

When internal control is found to be to an acceptable level, the accounting entries generated in such a system is more reliable than in one where the control is weak.

Mere satisfaction about the existence of internal control may not be sufficient for auditors to express opinion about the assertions the financial data in the form of balances and transactions. These i.e. transactions and balances need to be tested. This is done by audit procedure called substantial checking.

Substantial procedures are designed to obtain audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

The substantial procedures involve (a) checking of transactions and balances and (b) analytical review. The checking of transaction and balances involves vouching of sales, purchases, payments, receipts and scrutiny of ledgers.

The analytical procedure involves critically examining the accounts in an overall manner and it may entail computation of ratios, trend analysis so as to dwell in length for examination of unusual or unexplained deviations.

Question 6

- (a) Enunciate the General principles of verification of Assets. (8 Marks)
- (b) State the matters which the statutory Auditor should look into before framing opinion on accounts on finalisation of audit of accounts? Discuss over all audit approach. (8 Marks)

Answer

- (a) General principles of verification of Assets : It is not sufficient for the auditors only to verify correctness of the amount of assets shown in the balance sheet, he must verify them by actual inspection or otherwise and establish the existence of assets.

Points requiring auditor's attention for verification are as under:

- (i) Cost - In regard to assets, verification procedure need not generally be extended to determination of the correctness of costs and authority to incur costs unless the items concerned were purchased during the accounting period under review. In such cases the auditor should check the correctness of costs through normal vouching method. He should ensure that adequate distinction has been made between 'revenue' and 'capital' nature of costs.
- (ii) Ownership – Where ownership of assets is evidenced by documents of title etc. as in the case of immovable property, a reference should be made to such documents. If the documents are held by third person the auditor should either obtain a

certificate directly from that party or arrange to inspect them at the third party's place of business.

- (iii) Valuation - It must be ascertained that all assets are valued in accordance with appropriate accounting policy. For the valuation made, the basis must be consistently applied, unless circumstances necessitated a change. Even then a disclosure is required for the change and its monetary effect.
 - (iv) Existence – Physical inspection should be done wherever possible. Where physical inspection is not possible, the possibility of obtaining indirect evidence be considered e.g. machinery imported held in customs godown or materials sent to subcontractor for job work or fabrication. In such circumstances certifying of such parties should be obtained and if considered necessary even physical verification may be requested.
 - (v) Presentation in accounts - Material assets must be properly disclosed and correctly described in the accounts. It should be seen that the description given to them is clear and complete and is not misleading e.g. stating loans on the assets side of the balance sheet "as dependent upon realization" is just misleading as was held in the case of London and General Bank Ltd. care must be taken to see that disclosures required under the statute or statement issued by ICAI are complied with.
- (b) Formation of opinion on accounts: The principal aspect to be covered in an audit to form an opinion, an auditor has to look into following matters:
- (i) An examination of the system of accounting and internal control to ascertain whether it is appropriate for the business and helps in properly recording all transactions. This is followed by such tests and enquiries as are considered necessary to ascertain whether the system is in actual operation. These steps are necessary to form an opinion as to whether reliance can be placed on the records as a basis for the preparation of final statements of account.
 - (ii) Reviewing the system and procedures to find out whether they are adequate and comprehensive and incidentally whether material inadequacies and weaknesses exist to allow frauds and errors going unnoticed.
 - (iii) Checking of the arithmetical accuracy of the books of account by the verification of postings, balances, etc.
 - (iv) Verification of the authenticity and validity of transaction entered into by making an examination of the entries in the books of accounts with the relevant supporting documents.
 - (v) Ascertaining that a proper distinction has been made between items of capital and of revenue nature and that the amounts of various items of income and expenditure adjusted in the accounts corresponding to the accounting period.
 - (vi) Comparison of the balance sheet and profit and loss account or other statements with the underlying record in order to see that they are in accordance therewith.

- (vii) Verification of the title, existence and value of the assets appearing in the balance sheet.
- (viii) Verification of the liabilities stated in the balance sheet.
- (ix) Checking the result shown by the profit and loss and to see whether the results shown are true and fair.
- (x) Where audit is of a corporate body, confirming that the statutory requirements have been complied with.
- (xi) Reporting to the appropriate person/body whether the statements of account examined do reveal a true and fair view of the state of affairs and of the profit and loss of the organisation.

It will thus be realised that the duties of auditor are not limited to the verification of the arithmetical accuracy of the books of account kept by his client; he must also satisfy himself that entries in the books are true and contain a complete record of all the transactions of the business and these are recorded in such a manner that their real nature is revealed. On that account, he must examine all vouchers, invoices, minutes of directors or partners correspondence and other documentary evidence that is available to establish the nature and authenticity of the transactions. Besides, he must verify that there exists a proper authority in respect of each transaction; that each transaction is correctly recorded, etc. Finally, he must verify that the form in which the final accounts are drawn up is the one prescribed by law or is the one that ordinarily would present a true and fair picture of state of affairs of the business.

Question 7

- (a) The Vidhwat College, an institution managed by Dayal Trust, has received a grant of Rs 1.35 crore from Government nodal agencies for funding a project of research on rural health systems in India. Draft an audit programme for auditing this fund in the accounts of the college. (12 Marks)
- (b) What are the main points involved in 'Performance Audit' under Government Accounting system? (4 Marks)

Answer

- (a) Audit of grant fund of a college :
 1. The auditor should obtain the basic documents about the constitution of the college, objectives of the trust, rules of college etc.
 2. The government policy on grant should be checked with the relevant application, brochure, and sanction advices.
 3. The conditions stipulated in award of grant should be studied.
 4. The receipt of grant should be vouched with bank statement.

5. The budgeted heads of expenses for the project and actual utilization of the fund should be checked.
 6. The purchase of capital items covered within the project should be correctly capitalized. The same should be properly and distinctly shown in the balance sheet of the college. The cost of the asset should be adjusted for the grant amount.
 7. The expenses of revenue nature incurred from and out of grant in the form of salaries to field staff, materials purchased, traveling, survey and field work expenses and analysis and preparation of reports etc should be vouched with the relevant vouchers.
 8. The expenses should be accounted as withdrawal of amounts from the fund. It is to be checked that these expenses are not accounted in income and expenditure of the college.
 9. In balance sheet, the fund account should be shown as a liability with a separate schedule indicating the receipts, payments and balance as on the date of closing of accounts.
 10. The fund balance should be cross checked with the periodical statements of accounts submitted to the nodal agencies.
 11. The physical verification of assets pertaining to the project should be done by the management of the college.
 12. The progress of the project may be ascertained from the minutes, committee meeting extracts and reports. This must be done to ensure that the project fund is genuinely utilized for the purposes it intended for.
- (b) Performance Audit: Performance audit refers to an examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources. The examination is objective and systematic, generally using structured and professionally adopted methodologies.

The scope of audit has been extended to cover efficient, economy and effectiveness audit or performance audit.

Efficiency audit look into whether various schemes/projects are executed and their operations conducts economically & see that amount spent gives expected result & projects carried out in an economical manner.

Economy aspect looks whether government has acquired financial, human and physical resources in an economical manner and that sanctioning and spending authority have observed economy.

Effectiveness looks into appraisal of performance of programmes, schemes, projects with overall targeted objectives.

Efficiency cum performance audit is examination of Financial & operational aspect of performance.

The performance audit involves preliminary study, planning & execution of audit & reporting.

Question 8

Write short notes on the following: (any Four)

- (a) Disclaimer of opinion by an auditor.
- (b) Audit Report versus Audit Certificate.
- (c) Statutory Auditor versus Internal Auditor.
- (d) Fundamental Accounting assumptions
- (e) Audit versus Investigation.
- (f) Audit of Incomplete records. (4 X 4 = 16 Marks)

Answer

- (a) Disclaimer of opinion: The auditor issues a disclaimer of opinion when
1. He is unable to express his opinion in respect of matters concerning his areas of report.
 2. The inability to express opinion is due to (a) limitation on the scope of his audit work or (b) uncertainty affecting financial statements the resolution of which is dependent on future events.
 3. When disclaiming the opinion, the auditor expresses that he is unable to express any opinion about financial statements. It is neither a clean report nor a qualified or adverse report.

Example is when the records of the company are seized by excise authority, the auditor would say that he is unable to form an opinion in view of non-availability of records.

- (b) Audit report versus certificate :
1. Audit report is an expression of opinion on the truth and fairness of the accounts.
 2. Audit certificate is authentication of true and correctness of the data or fact certified.
 3. The existence of opinion distinguishes a report from the certificate.
 4. The example of audit report is report issued by statutory auditor of a company under section 227 of the Companies Act 1956.
 5. The example for audit certificate is certification of consumption of imported items to be submitted to the government department for obtaining some license etc.

- (c) Statutory Auditor versus Internal Auditor :

STATUTORY AUDITOR

1. The extent of the work undertaken by statutory auditor arises from the responsibility placed on him by the statutes.
2. The approach of this auditor is governed by his statutory duty to satisfy himself that the accounts to be presented to the shareholder show a true and fair view of the financial position.
3. This auditor is responsible directly to the shareholder.
4. External auditor is not the employee of the company so he has independent status.

INTERNAL AUDITOR

- The extent of the work undertaken by the internal auditor is determined by the management.
- The approach of this auditor is with a view to satisfy that the accounting system is efficient, so that the accounting information presented to the management is accurate and discloses material facts.
- This auditor is responsible to management.
- Internal auditor is an employee of the company. So he can not enjoy independence that statutory auditor has.

- (d) Fundamental accounting assumptions: Accounts are prepared based on certain assumptions of accounting policies. These need not be specifically disclosed in accounts. When these assumptions are not followed, then only they need to be indicated in notes to the accounts.

There are three fundamental accounting assumptions as listed in AS 1. They are going concern concept, consistency and accrual.

Going concern concept implies that the entity will carry on its business in future and it does not have any specific intention of closing. This implies that fixed assets will be valued at cost less depreciation in contrast to current assets which are valued at lower of cost and net realizable values.

Accrual concept implies that the all income and expenditure should be accounted irrespective of their payment/ receipt upon their incurring/ accruing.

Consistency implies that the accounting policies are consistent from one period to another.

- (e) Auditing versus Investigation: Audit is generally objected to find out whether the accounts show true & fair view. It is a critical examination of books of accounts.

Investigation on the other hand is critical examination of the accounts with a special purpose. For example if fraud is suspected and an accountant is called upon to check the accounts to whether fraud really exists and if so, the amount involved, the character of the enquiry changes into investigation. Investigation may be undertaken in numerous areas of accounts, e.g., the extent of waste and loss, profitability, cost of production etc. It extends scope beyond books of accounts.

For auditing on the other hand, the general objective is to find out whether the accounts show a true and fair view. The auditor seeks to report what he finds in the normal course of examination of the accounts adopting generally followed techniques unless circumstances call for a special probe. Fraud, error, irregularity, whatever comes to the auditor's notice in the usual course of checking, are all looked into in depth and sometimes investigation results from the prima facie findings of the auditor.

- (f) Audit of Incomplete Records: Audit of incomplete Records generally required under two circumstances.
- (i) When accounts have been maintained on single entry basis or
 - (ii) Accounting record may be destroyed by fire, flood etc. or seized by government authorities.

The auditor may be required to follow extensive procedures, which include:

- (a) obtain list of records available
- (b) Ensure that management reconstructs/compile records to the extent possible.
- (c) Perform compliance procedure to assess whether internal control system is in operation.
- (d) Vouch transactions in books of accounts with appropriate evidence.
- (e) Examine system of custody of cash receipts, cheque book etc.
- (f) Conduct surprise verification of cash & inventory.
- (g) Verify fixed assets by physical verification.
- (h) Formulate appropriate audit opinion.

A disclaimer of opinion may be necessary if any restriction on scope of audit is enforced.