



## Guideline Answers for Auditing & Assurance

1 Discuss the following –

(a) Advantages of Independent Audit. (Any 5 points)

[5 Marks]

The advantages of an independent audit include –

1. **Protection of Interests:** Independent audit safeguards the financial interest of persons who are not associated with the Management of the Firm, whether they are Partners or Shareholders.
2. **Moral Check:** Audit acts as a moral check on the employees from committing defalcations / embezzlement.
3. **Tax Liability:** Audited statements of account are helpful in settling liability for taxes.
4. **Credit Negotiation:** Financiers and Bankers use audited Financial Statements in evaluating the credit worthiness of individuals in negotiating loan. It is also useful for determining the purchase consideration for a business.
5. **Trade Dispute Settlement:** Audited statements are also useful for settling trade disputes for higher wages or bonus as well as claims for damages to property due to fire or some other calamity.
6. **Control over Inefficiency:** Audited Statements prove useful to detect wastages and losses. It shows the different ways by which wastages or losses might be checked, and those that occur due to the absence or inadequacy of internal checks or internal control measures.
7. **Funds-in-Trust:** Audit is a mechanism which ensures that persons acting for others have properly accounted for the amounts collected by them, e.g. Partners, Agents, Liquidators, Receivers, Trustees, etc.
8. **Arbitration:** Audited Financial Statements are useful in settling disputes by arbitration.
9. **Appraisal:** Audit reviews the existence and operations of various controls in the Firm and reports inadequacies, weaknesses, etc. in them. Management can take suitable action based on the reports.
10. **Partnership Cases:** Audited accounts are of great help in the settlement of accounts, valuation of goodwill, etc. at the time of admission or death of a Partner.
11. **Assistance to Government:** Government may require audited and certified statements before it gives assistance or issues a license for a particular trade.

(b) Highlight 5 indicators that affects Going Concern assumptions as per SA 570– Going Concern. (Any 5 points)

[5 Marks]

**Note:** Events or Conditions that may cast doubt about Going Concern Assumption.

Financial	Operating	Others
<ul style="list-style-type: none"> <li>• Net Liability or Net Current Liability position.</li> <li>• <b>Fixed–Term Borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on Short–Term Borrowings to finance Long–Term Assets.</b></li> <li>• Indications of withdrawal of financial support by Creditors.</li> <li>• Negative Operating Cash Flows indicated by historical or prospective Financial Statements.</li> <li>• Adverse key Financial Ratios.</li> <li>• <b>Substantial Operating Losses or significant deterioration in the value of assets used to generate Cash Flows.</b></li> <li>• Arrears or discontinuance of Dividends.</li> <li>• Inability to pay Creditors on due dates.</li> <li>• Inability to comply with the terms of Loan Agreements.</li> <li>• Change from credit to cash–on–delivery transactions with Suppliers.</li> <li>• Inability to obtain financing for essential new product development or other essential investments.</li> </ul>	<ul style="list-style-type: none"> <li>• Management intentions to liquidate the Entity or to cease operations.</li> <li>• Loss of Key Management without replacement.</li> <li>• <b>Loss of a major market,</b> key customer(s), franchise, license, or principal Supplier(s).</li> <li>• Labour difficulties.</li> <li>• Shortages of important supplies.</li> <li>• Emergence of a highly successful competitor.</li> </ul>	<ul style="list-style-type: none"> <li>• Non–compliance with capital or other statutory requirements.</li> <li>• Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.</li> <li>• <b>Changes in law or regulation or Government</b> policy expected to adversely affect the entity.</li> <li>• Uninsured or under–insured catastrophes when they occur.</li> </ul>



(c) What is meant by Letter of Engagement? What are its purposes? (Any 5 points)

[5 Marks]

If Reference to SA 210 is given, additional weightage in Marks shall be considered.

Situation	Auditors' Duties
<p><b>Audit Terms not prescribed by Law or Regulation</b></p> <p><b>Note:</b> Points (a) to (e) are mandatory. Other items may be included in Audit Engagement Letter, wherever relevant.</p>	<p>The agreed terms of the Audit Engagement shall be recorded in an Audit Engagement Letter or other suitable form of Written Agreement, and shall <b>include</b> –</p> <ul style="list-style-type: none"> <li>(a) Objective and Scope of the audit of the Financial Statements,</li> <li>(b) Responsibilities of the Auditor,</li> <li>(c) Responsibilities of Management,</li> <li>(d) Identification of the applicable Financial Reporting Framework for the preparation of the Financial Statements, and</li> <li>(e) Reference to the expected Form and Content of any Reports to be issued by the Auditor and a Statement that there may be circumstances in which a Report may differ from its expected form and content.</li> <li>(f) Form of any other communication of results of the audit engagement.</li> <li>(g) The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material mis-statements may not be detected, even though the audit is properly planned &amp; performed in accordance with SAs.</li> <li>(h) Arrangements regarding the planning and performance of the audit, including the composition of the Audit Team.</li> <li>(i) The expectation that Management will provide written representations.</li> <li>(j) The agreement of Management to make available to the Auditor, Draft Financial Statements and any accompanying other information in time to allow the Auditor to complete the audit in accordance with the proposed timetable.</li> <li>(k) The agreement of Management to inform the Auditor of facts that may affect the Financial Statements, of which Management may become aware during the period from the date of the Auditor's report to the date the Financial Statements are issued.</li> <li>(l) Basis on which fees are computed and any billing arrangements.</li> <li>(m) Request for Management to acknowledge receipt of the Audit Engagement Letter and to agree to the terms of the engagement outlined therein.</li> <li>(n) The fact that the audit process may be subjected to a Peer Review under the CA Act, 1949.</li> <li>(o) Arrangements concerning the involvement of Other Auditors and Experts in some aspects of the audit.</li> <li>(p) Arrangements concerning the involvement of Internal Auditors and other Staff of the Entity.</li> <li>(q) Arrangements to be made with the Predecessor Auditor, if any, in the case of an initial audit.</li> <li>(r) Any restriction of the Auditor's liability when such possibility exists.</li> <li>(s) Reference to any further agreements between the Auditor and the Entity.</li> <li>(t) Any obligations to provide Audit Working papers to other parties.</li> </ul>

(d) Write notes on Sampling Risk and its effects as per SA 530 – Audit Sampling.

[5 Marks]

For Definition of Sampling Risk – 2 Marks; Effects of Sampling Risk – 3 marks

<p><b>Sampling Risk</b></p>	<p>The risk that the Auditor's conclusion based on a sample may be <b>different</b> from the conclusion if the entire population were subjected to the same audit procedure. Sampling Risk can lead to two types of erroneous conclusions –</p>			
	<p><b>Error Type</b></p>	<p><b>In case of Test of Controls</b></p>	<p><b>In case of Test of Details</b></p>	<p><b>Effect of this erroneous conclusion</b></p>
	<p><b>Type I</b></p>	<p>That Controls are more effective than they actually are (i.e. Risk of over reliance)</p>	<p>That a material mis-statement does not exist, when in fact it does (i.e. Risk of incorrect acceptance)</p>	<p>This affects <b>audit effectiveness</b>, and is more likely to lead to an inappropriate audit opinion.</p>



	<b>Type II</b>	That Controls are less effective than they actually are (i.e. Risk of under reliance)	That a material mis-statement does exist, when in fact it does not (i.e. Risk of incorrect rejection)	This affects <b>audit efficiency</b> , as it would usually lead to additional work to establish that initial conclusions were incorrect.
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2. State briefly whether the following statements are Correct or Incorrect:(Answer any Eight) [8 × 2 = 16 Marks]

(a) Auditor is required to provide Absolute Assurance.	<b>Incorrect:</b> He is expected to provide Reasonable Assurance.
(b) The Auditor compares entries in Books of Accounts with Vouchers, and if the two agrees, his work is done.	<b>Incorrect:</b> He should express as opinion on the Financial Statements
(c) Auditor is primarily responsible for establishing, maintaining and reviewing the Internal Control System.	<b>Incorrect:</b> It is the responsibility of the management.
(d) 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.	<b>Incorrect:</b> It should be under official custody ant not under personal custody.
(e) As per SA-500, Management's Expert is a person who is having Technical knowledge in all areas.	<b>Incorrect:</b> Expert is a person having Technical Knowledge in <b>areas other than Accounting or Auditing.</b>
(f) General Clarifications issued by ICAI are recommendatory in nature.	<b>Incorrect:</b> They are mandatory in nature as they are issued to clarify on Statements/ Standards
(g) The Auditor shall express an Qualified Opinion, if the Auditor is unable to obtain sufficient audit evidence and the misstatements in Financial Statements are both material and pervasive.	<b>Incorrect:</b> Disclaimer of opinion is to be issued.
(h) The First Auditor should be appointed within 60 days from the date of Registration of the Company.	<b>Incorrect:</b> Should be appointed <b>within 30</b> days from the date of Registration.
(i) Interim Audit acts as a Good Internal Control Tool.	<b>Incorrect: Concurrent Audit</b> act as a Good Internal Control tool.
(j) An Auditor is bound to provide copies of the Working Papers to the CEO of the Company.	<b>Incorrect:</b> It is the property of the Auditors and at the discretion of Auditor he may provide, but there is no duty to provide.

3. How you will vouch/verify the following? [4 × 4 = 16 Marks]

(a) Payment of Customs and Excise Duty. (Any 5 points)

Any 5 Points from both ED and Customs Duty

**EXCISE DUTY:** The Liability for Excise Duty arises at the time of completion of manufacture. It is a manufacturing expense and hence should be charged to Trading Account.

Aspect	Matters to be verified / Auditors' Duties
<b>E-payment</b>	Verify actual amount of Excise Duty paid from the counterfoils of the e-payment challan.
<b>PLA and RG Registers</b>	<ul style="list-style-type: none"> <li>Trace the entry relating to payment in the PLA Register and Bank Statements.</li> <li>Also check the registers with copies of Sales Invoices for verifying debit entries.</li> </ul>
<b>Analytical Review of Excise Duty debits / payments</b>	<ul style="list-style-type: none"> <li>Ascertain the rates of Excise Duty and apply it on the Total Sales.</li> <li>See that the amount actually paid does not exceed the amount calculated.</li> <li>See whether the Closing Balance in PLA and RG Account as per Monthly Returns, tallies with the Financial Statements.</li> </ul>
<b>Duty Drawback Claims</b>	In case of exports, verify whether Duty Drawback has been properly claimed.
<b>CENVAT Credits</b>	Ensure that CENVAT Credit is correctly claimed in respect of Raw Materials, as well as on Capital Goods, as per the applicable legal provisions. Examine proper accounting thereof as per accepted accounting principles.



Aspect	Matters to be verified / Auditors' Duties
Monthly Returns	Cross-check the Excise Duty amounts paid and CENVAT Credit claimed, with the monthly Return (ER-1) submitted to Excise Authorities.

**CUSTOMS DUTY**

Aspect	Matters to be verified / Auditors' Duties
Bill of Entry	Verify the Bill of Entry to ascertain actual import of goods and other pertinent details relating to the consignment.
Receipt for payment of Customs Duty	<ul style="list-style-type: none"> <li>Vouch the payments made based on the Challan / Receipt.</li> <li>Examine the Agent's Bill where the Customs Duty is paid through Clearing &amp; Forwarding Agents.</li> </ul>
Provisional Assessment and other orders	<ul style="list-style-type: none"> <li>In case of dispute as to amount payable, verify the provisional amount paid in lieu of the final amount. Also verify the final amount determined as payable.</li> <li>When the provisional payment was more than the actual amount, verify the refund / adjustment of such excess amount.</li> </ul>

## (b) Depreciation

Any 5 Points – Reference to Companies Act Sch II, AS-6, AS-10 shall be considered for weightage in marks

## 1. Auditors' Duties:

Aspect	Matters to be verified / Auditors' Duties
Method	Ascertain the method of depreciation, determine its appropriateness and assess that useful life of the assets have been estimated properly.
Consistency	Verify whether the method of computation of depreciation is consistent with the previous years. In case of change in method, ensure compliance with the applicable AS.
Useful Life of Asset	Obtain suitable explanations/ justification from Management in cases where the Depreciation is different from that prescribed in <b>Schedule II to the Companies Act</b> .
Amounts	Ensure that the depreciable amount of an asset has been allocated on a systematic basis to each accounting period during the useful life of the asset.
Disposed Assets	Verify whether appropriate terminal depreciation has been charged in respect of assets sold, discarded or demolished in the year.
Revalued Assets	Ensure that proper depreciation has been charged on revalued assets.
Reserve	Any amount included in the provision for depreciation, which is considered to be in excess of the requirement should be shown as Reserve.
Compliance	Ensure that provisions of <b>AS – 6, AS – 10</b> , AS – 11, AS – 26 and AS – 28 have been complied with, in connection with – (a) determination of cost, (b) adjustment of cost, (c) charging of depreciation and amortization, and (d) disclosure of carrying amount in the Balance Sheet.

## (c) Remuneration paid to Directors. (Any 5 points)

Aspect	Matters to be verified / Auditors' Duties
Minutes Book	Examine the General Meeting or Board Meeting Resolution for the appointment and terms of appointment of the Director(s).
Articles of Association	Examine AOA and General Meeting Resolution to determine the authority to pay and mode of payment – monthly, quarterly payments or by way of commission.
Form 32 / Register of Directors	Verify whether the person to whom Remuneration is paid is a Director for the period of payment. Confirm the same based on Returns filed with ROC.
Agreement	Examine whether the agreement with the Director is in accordance with Articles, Resolutions and other legal aspects.
Minutes Book	Verify whether the Director has attended the Board Meetings.



Aspect	Matters to be verified / Auditors' Duties
<b>Companies Act, 2013</b>	<ul style="list-style-type: none"> <li>Ensure compliance with the provisions of Sec. 197, 198 Schedule V of the Companies Act, wherever applicable.</li> <li>Check computation of Net Profits and Commission payable to Directors under Companies Act.</li> </ul>
<b>Payment Voucher</b>	Verify the following aspects – <ul style="list-style-type: none"> <li><b>Eligibility</b> – whether the payment is in accordance with Articles of Association?</li> <li><b>Computation</b> – whether the amount due has been properly computed?</li> <li><b>Discharge</b> – whether proper receipt / acknowledgement has been obtained?</li> </ul>
<b>Financial Statements / Others</b>	<ul style="list-style-type: none"> <li>Verify whether payment made has been properly disclosed as per the requirements of the Companies Act.</li> <li>Verify whether TDS has been deducted at the appropriate rates and remitted within the due dates stipulated under the Income Tax Act.</li> </ul>

## (d) Discounted Bills Receivable Dis-honoured.

Aspect	Matters to be verified / Auditors' Duties
<b>Bill-wise Schedule</b>	Obtain a Schedule of Bills Discounted dishonoured and examine the same.
<b>Bank Statement</b>	<ul style="list-style-type: none"> <li>Trace the credit entry and subsequent dishonour entry in the Bank Statement.</li> <li>Confirm that no debit is raised by the Banker for dishonour, without first crediting the amount to Entity's account.</li> </ul>
<b>Bill Receivable</b>	<ul style="list-style-type: none"> <li>Verify whether B/R has been returned along with Banker's advice.</li> <li>Ensure that the dishonour has been properly "noted" on the B/R.</li> </ul>
<b>Debtors Ledger</b>	<ul style="list-style-type: none"> <li>Verify entries for dishonour passed in the Parties account.</li> <li>See whether Bank Charges, Noting Charges, etc. have been debited to party.</li> </ul>
<b>Lawyer Correspondence File</b>	Examine correspondence with lawyer and other subsequent events, which may provide other evidence of the debt becoming doubtful or bad.

## 4. With reference to Companies Act, 2013, Explain:

- (a) What is the tenure of the Auditor appointed in an AGM? Explain the Steps involved in Removal of Auditor before expiry of term? [6 Marks]

Term: Auditor is appointed from the end of 1<sup>st</sup> AGM till the conclusion of 6<sup>th</sup> AGM. (Period of 5 Consecutive years) (1 Mark)

(5 Marks)

<b>Procedure for Removal before expiry of term</b>	<ol style="list-style-type: none"> <li><b>BOD</b> should pass a <b>Resolution</b> for removal of Auditors.</li> <li>Application should be made to Central Government in <b>Form ADT-2, within 30 days</b> of BOD Resolution.</li> <li><b>Previous Approval</b> of Central Government should be obtained, in response to Form ADT-2.</li> <li>A <b>General Meeting</b> should be held <b>within 60 days</b> of receipt of approval from Central Government.</li> <li><b>Special Resolution</b> should be passed in the above General Meeting, for removal of Auditors.</li> <li>Before taking any action u/s 140(1), the Auditor shall be given a reasonable opportunity of being heard.</li> </ol>
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- (b) When Internal Audit is mandatory to a Company?

[6 Marks]

The provisions relating to Internal Audit are as under –

Particulars	Description
<b>Companies required to appoint Internal</b>	<ol style="list-style-type: none"> <li>Every Listed Company</li> <li>Every Unlisted Public Company, during the preceding Financial year having –               <ol style="list-style-type: none"> <li>Paid Up Share Capital of ₹ 50 Crores or more, or</li> <li>Turnover of ₹ 200 Crores or more, or</li> </ol> </li> </ol>

[4 Marks]



Particulars	Description
<b>Auditor</b>	(c) Outstanding Loans or Borrowings from Banks or Public Financial Institutions exceeding ₹ 100 Crores or more at any point of time during the preceding financial year, or (d) Outstanding Deposits of ₹ 25 Crores or more at any point of time during the preceding financial year. 3. Every Private Company having – (a) Turnover of ₹ 200 Crores or more during the preceding financial year, or (b) Outstanding Loans or Borrowings from Banks or Public Financial Institutions exceeding ₹ 100 Crores or more at any point of time during the preceding financial year.
<b>Conditions as to appointment</b>	1. Internal Auditor may be an Individual or a Firm. <span style="float: right;">[1 Mark]</span> 2. Internal Auditor, shall either be a Chartered Accountant or a Cost Accountant, or such other Professional as may be decided by the Board to conduct internal audit of the functions and activities of the Company. 3. The term Chartered Accountant shall mean a CA, whether engaged in practice or not. 4. The Internal Auditor may or may not be an Employee of the Company.
<b>Existing Companies</b>	Existing Company covered under any of the above criteria shall appoint Internal Auditor within the month of Sep 2014 (i.e. 6 months from the commencement of this section). <span style="float: right;">[1 Mark]</span>

**(c) Utilisation of Securities Premium Account.****[4 Marks]**

<ul style="list-style-type: none"> <li>• Ensure that the Securities Premium is disclosed under the separate head called Securities Premium Account. The balance shall be shown distinctly under "Reserves and Surplus" in the Balance Sheet.</li> <li>• Ensure utilisation of Securities Premium as per Sec.52, and see whether such use is clearly shown under that sub-head in the Balance Sheet. As per Sec.52, Securities Premium may be applied in – <ul style="list-style-type: none"> <li>(a) Issuing <b>Fully Paid Bonus Shares</b> to Members.</li> <li>(b) Writing-off the <b>Preliminary Expenses</b> of the Company.</li> <li>(c) Writing off the – (i) Expenses Incurred, or (ii) Commission Paid, or (iii) Discount Allowed, on the Issue of Shares or Debentures of the Company.</li> <li>(d) Providing for <b>premium payable</b> on redemption of any Redeemable Preference Shares or Debentures of the Company.</li> <li>(e) <b>Buy-back</b> of own Shares or Other Securities u/s 68.</li> </ul> </li> </ul>
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**5(a) What do you mean by Audit Evidence? Discuss the principles relating to its reliability.****[8 Marks]****Reference to SA 500 – Shall be given 1 mark**

1. **Audit Evidence** :Information used by the Auditor in arriving at the conclusions on which the Auditor's opinion is based. Audit Evidence includes both information contained in the accounting records underlying the Financial Statements and other information.
2. **Reliability**: Reliability of the audit evidence, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. The general rules about the reliability of audit evidence are –
  - (a) Reliability of audit evidence is **increased when it is obtained from independent sources outside the Entity**. However, such information may not be reliable if the source is not knowledgeable, or a Management's Expert may lack objectivity.
  - (b) Reliability of audit evidence that is generated internally is increased when the **related controls**, including those over its preparation and maintenance, imposed by the **entity are effective**.
  - (c) **Audit Evidence obtained directly by the Auditor** (e.g. observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (e.g. inquiry about the application of a control).
  - (d) **Audit Evidence in documentary form**, whether paper, electronic, or other medium, is more reliable than evidence obtained orally.
  - (e) **Audit Evidence provided by original documents is more reliable than audit evidence provided by photocopies** or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.



- 5(b) How far is the Internal Audit is useful to the Statutory Auditor? To what extent the Statutory Auditor can rely on the Internal Audit Report? [8 Marks]

Reference to SA 610 – Shall be given 1 mark

#### CO-ORDINATION BETWEEN INTERNAL AND EXTERNAL AUDITOR

1. **Mutual Communication:** The External Auditor should inform the Internal Auditor of any significant matters, which may affect his work. It is desirable that the External Auditor is advised of, and has access to relevant internal audit reports and also informed, of any significant matter that comes to the Internal Auditor's attention and which may affect the work of the External Auditor.

#### RELYING UPON INTERNAL AUDITORS:

1. **Reliance on Internal Audit:SA-610** states that the External Auditor should, as part of his audit, evaluate the internal audit function to the extent he considers that it will be relevant in determining the nature, timing and extent of his compliance and substantive procedures.
2. **Commonality of Audit Approach:** There is considerable similarity in the functions and areas of operation of internal and Statutory Auditor, e.g. –
  - (a) Common interest in ensuring that the internal check is effective.
  - (b) Common interest to ascertain whether the accounting system is adequate to generate true and fair Fin.Statements.
  - (c) Examination of the same set of accounting documents.
  - (d) Adoption of similar verifactory checks & audit procedures, e.g. stock verification, physical inspection, etc.
3. **Effect of Internal Audit:**
  - (a) The Statutory Auditor may plan his audit after taking into account the work performed by the Internal Auditors. **Based on such evaluation, he may be able to adopt less extensive procedures than would otherwise be required.**
  - (b) He may reduce his area of checking wherever he feels that the internal audit is adequate and effective.
  - (c) In areas involving routine and repetitive transactions covered by internal audit, the Statutory Auditor may decide to adopt sample testing procedures.
4. **Responsibility of External Auditor:**
  - (a) In spite of the existence of internal audit function, the Statutory Auditor's responsibility is absolute.
  - (b) Any reliance he places upon the work performed by the Internal Auditors is part of his audit approach. It does not reduce his duty to exercise sufficient professional care and skill before he pronounces an audit opinion.
  - (c) Therefore, an Auditor cannot ignore checking of the areas already checked by the Internal Auditors.

- 6(a) Mention any Eight Important points which an Auditor will consider while conducting the audit of Hotels. [8 Marks]

Any 8 Points

The following matters deserve the Auditors' attention in the audit of a Hotel –

Aspect	Auditors' Duties
<b>Internal Control – Room Sales</b>	<ul style="list-style-type: none"> <li>• Verify the Room Sales Collections from the Guest Register.</li> <li>• Sometimes, daily occupancy reports and extra bed supply reports are prepared. In such cases, test-check a few reports with the Guest Register and with the individual guest's bill, to ensure proper billing.</li> <li>• See whether standard room rates have been charged in various guests' bills. In case of difference, obtain satisfactory explanation and sanction for the same.</li> </ul>
<b>Internal Control – Restaurant Billing and Sales</b>	<p>All sales points in a hotel make both cash and credit sales. The Auditor should examine the internal control system as regards – (a) procedure for billing customers for room service and sundry services, (b) procedure for issue of provisions and commodities, and (c) safe custody of edibles, beverages, drinks, crockery, cutlery, linen, furniture, etc. The Auditor should –</p> <ul style="list-style-type: none"> <li>• Perform compliance tests to ensure that the internal control system operates effectively.</li> </ul>



Aspect	Auditors' Duties
	<ul style="list-style-type: none"> <li>Reconcile the total sales reported with the total of the bills issued by the sale point, either in the form of a bill roll or a series of numerically controlled bills.</li> <li>Check the numerical control system to ensure that all bills are included in the total.</li> <li><b>Verify a few restaurant bills by reference to KOT's (Kitchen Order Tickets) or basic record.</b></li> <li>Trace the cash element of sales into the Cash Scroll / Cash Book and the credit sales in total and detail to the guest's bills.</li> </ul>
<b>Internal Control – Stocks</b>	<ul style="list-style-type: none"> <li>Examine the documentation procedure in respect of stocks, since Hotel Stocks are readily – (a) movable /portable, and (b) saleable, e.g. Provisions, Food, Beverages, etc.</li> <li>Perform compliance tests to ensure that all such documentation is accurately processed.</li> <li>See whether stocks are kept under safe custody under the supervision of the Department Manager.</li> <li>Ensure that movement of provisions and goods in or out of the stores takes place only after proper authorisation and recording.</li> <li>Supervise the physical stock-taking and test check pricing calculations.</li> <li>Verify the basis of valuation adopted for stocks. In case of specialized professional valuation, examine whether the valuation is done reasonably and consistently on a systematic basis.</li> </ul>
<b>Casual Labour</b>	<p>Generally, hotels employ casual labour to a very large extent, in many of their departments. Hence, the Auditor should –</p> <ul style="list-style-type: none"> <li>Examine the wage payment registers and attendance records to see whether any manipulation has been made.</li> <li>Verify whether adequate records, as required by law, wherever applicable, have been maintained.</li> </ul>
<b>Commission Payments</b>	<p>In case of bookings through travel agents, hospitality agents, corporates (for their guests) or other booking agencies, the Auditor should –</p> <ul style="list-style-type: none"> <li>Verify that the amounts due are recovered from agents as per the terms of credit allowed.</li> <li>Check the commission, if any, paid to agents by reference to the agreement.</li> </ul>
<b>Fixed Assets</b>	<ul style="list-style-type: none"> <li>Obtain a schedule of Fixed Assets and verify whether adequate depreciation has been provided at the prescribed rates.</li> <li>Verify whether the capitalization and depreciation policies followed by the Institution have been consistently followed.</li> <li>Conduct physical inspection of Fixed Assets and obtain management certificates for periodic inspection thereof.</li> <li>Examine the method of recording certain assets e.g. Silver Cutlery taken as stock items in certain hotels and as Fixed Assets in other hotels. It is important that comprehensive definition of stock items exists and the Auditor should consider that whether or not the same have been properly followed in reality.</li> </ul>
<b>Statutory Compliance</b>	<ul style="list-style-type: none"> <li>Note the provisions, rules and regulations of various laws governing the operation of hotels, e.g. the Shops and Establishments Act, Local Sales Tax Acts, Regulations laid down by the Department of Tourism, RBI regulations in respect of foreign exchange transactions, etc.</li> <li>Verify whether the conditions of licence for running the hotel have been complied with.</li> <li><b>See whether all foreign exchange transactions have been properly entered into and appropriately reported in the accounts.</b></li> <li>See whether all taxes collected on food and occupation have been remitted to the proper authorities.</li> </ul>
<b>Analytical Review</b>	<ul style="list-style-type: none"> <li>Trace the consumption shown in various physical stock accounts, to customers' bills on a sampling basis wherever practicable or to appropriate consumption account to ensure that all issues have been billed and accounted for.</li> <li>Work out the occupancy rate and compare the same with other similar hotels and with the previous year. Investigate material deviations.</li> <li>Compare the expenses and receipts with the figures of the previous year having regard to the average occupancy of visitors and changes in the rates.</li> </ul>
<b>General</b>	<ul style="list-style-type: none"> <li>Verify whether payments made to foreign collaborator, if any, are in accordance with the terms of agreement.</li> <li>Vouch receipts on account of letting out of the Auditorium space and other spaces for shops and boutiques and for special shows etc. with reference to respective agreements.</li> <li>Examine the Customers' Ledger on a sample basis but in depth to see that all charges that should be made to the customers are in fact made.</li> </ul>





Aspect	Auditors' Duties
	<ul style="list-style-type: none"> <li>• Check whether income receivable but not yet billed has been accounted for in respect of – (a) Room Charges, and (b) Value of services rendered to customers still in occupancy on the closing day.</li> <li>• Check whether costs of re-decoration and renovation of buildings and facilities have been properly accounted for.</li> <li>• See whether provision for replacement of Current Assets like carpets, linen, etc. is made.</li> <li>• Verify the Share Capital, Reserves and Surplus, Secured and Unsecured Loans.</li> <li>• Verify whether the form and manner of presentation of financial information conforms to Accounting Standards and applicable legal requirements.</li> <li>• Obtain appropriate Management Representations and Certificates, in respect of the various aspects covered during the course of audit.</li> </ul>

6(b) Explain the uses of Audit Note Book.

[4 Marks]

**Importance:**

- Evidence Value:** Specific observations, which require follow up are maintained systematically covering the entire range of audit work done by the Auditor. Audit Notebook constitutes important evidence of work done and points considered in the course of an audit.
- Report Finalisation Value:** In the course of follow-up, the observations may get settled with explanation and evidence produced by the Management at a subsequent stage. Thereafter, the Auditor is left with only the unsettled observations and considers them from various relevant angles for preparing the Audit Report. The Audit Notebook is the primary basic document in preparing the Audit Report on the true and fair view of the Financial Statements.
- Audit Process Value:** The Audit Notebook provides new thrusts and direction in the manner, extent and timing of audit checkings.
- Control Value:** The Audit Notebook will show the extent and coverage of work done when the assistants are shifted or when there is a temporary stoppage of work.
- Protection Value:** The Audit Notebook, being a comprehensive record of work done and audit observations, is extremely valuable to the Auditors as a document of defence when a charge is brought against the Auditor for negligence and other shortcomings in the audit work.
- Planning Value:** The Audit Notebook is also a very useful document to plan for the next audit of the entity as also in preparing the next audit programme as the weaknesses shown in the Audit NoteBook on various aspects and segments of accounting would require close follow-up.

6(c) What do you mean by Compliance procedures and when it is performed?

[4 Marks]

The audit procedures in obtaining audit evidence are –

Particulars	Compliance Procedures
<b>Definition</b>	These are tests designed to obtain reasonable assurance that those internal controls on which reliance is to be placed are in effect.
<b>Types</b>	<b>These constitute the general tests of the internal control system.</b>
<b>Nature of Evidence</b>	Compliance Test seeks to provide evidence that the internal control system is being applied as prescribed.
<b>Purpose</b>	The Auditor carries out compliance tests to assess the efficiency of the internal control system.
<b>Assertions</b>	The Auditor is concerned with the following assertions – (a) <b>Existence</b> – That the internal control exists. (b) <b>Effectiveness</b> – That the internal control is operating effectively. (c) <b>Continuity</b> – That the internal control has operated continuously throughout the period of intended reliance.
<b>Nature of Check</b>	<b>It constitutes a check on the system of internal control.</b>
<b>Examples</b>	Compliance Tests are conducted in areas governed by the internal control, e.g. Purchases, Sales, etc.



## 7. Answer any four of the following with reference to Companies Act, 2013 –

[4 × 4 = 16 Marks]

- (a) Due to resignation of its Existing Auditors, the Board of Directors of Ambarish Ltd, appointed Hari as its Auditor. Is Hari's appointment valid?

Casual Vacancy can be filled by the BOD within 30 days. If Vacancy is caused by resignation, **the appointment should also be approved by the Company at General Meeting convened within 3 months of BOD recommendation.** So, Hari's appointment is valid, provided the above condition is satisfied.

- (b) Amaresh, a CA in practice is a Statutory Auditor of MNO Ltd. He purchased a car from the Company under the Hire Purchase Scheme run by the Company on the same terms and conditions as applicable to all other customers. The cash down price of the car is ₹ 80,000. The Initial payment of 25% was made on signing the Hire Purchase Agreement and the balance is payable in 24 monthly instalments. Is Amaresh disqualified to act as Auditor? Why?

1. An Auditor of a Company can purchase goods or services from the Company audited by him, provided it is in the **ordinary course of Business at Arm's Length Price. Such Business Relationship is not treated as a disqualification.**
2. If the amount outstanding exceeds ₹ 5,00,000 irrespective of the nature of the purchase or period of credit allowed to other customers, the disqualification u/s 141(3) will be attracted.
3. So, Amaresh is **qualified** to continue as Auditor of the Company.

- (c) Akilan Management Consultants Ltd is a registered Company with Akilan, Kapilan and Veeran as its Directors. All the three Directors are CA's. Can the Company be appointed as Auditor of another Company? Would your answer be different if Akilan Management Consultants Ltd is an LLP?

1. Sec.141(3)(a) provides that a Body Corporate (other than LLP) **cannot** be appointed as Statutory Auditor of a Company. In this case, the Company cannot be appointed as Statutory Auditor of another Company.
2. However, if the same is an LLP, it can be appointed as the Statutory Auditor of the Company.
3. Sec.141(1) says that where a Firm (including a LLP) is appointed as Auditor of the Company, only the **Partners who are Chartered Accountants and Holding COP** are authorised to act and sign on behalf of the Firm.

- (d) The Managing Director of PQR Ltd, himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as a First Auditor of the Company. Comment on the proposed action of the Managing Director.

1. Sec.139(6) specifies that the Board of Directors can appoint the First Auditor(s) within 1 month from the date of incorporation of the Company.
2. If the **Managing Director himself** wants to appoint the First Auditor(s), without consulting the Board / without the authority of the Board, such proposed appointment will be **ineffectual** and **invalid in law**.

- (e) The Board of Directors of a Company have filed a complaint with the Institute of Chartered Accountants of India against their Statutory Auditors for their falling to attend the Annual General Meeting of the Shareholders in which audited accounts were considered. As an Auditor, comment on the above.

1. **Right of Auditors:** The Company Auditor has the right to receive notices and to attend AGM u/s146.
2. **Duty of Auditors:** Unless otherwise exempted by the Company, the Auditor shall attend the General Meeting –
  - either by himself, or
  - through his Authorised Representative, who shall also be qualified to be an Auditor.
3. **Conclusion:** From the above, the contention of the Board of Directors for filing a suit against the Auditor, with the Institute of Chartered Accountants of India for the reason that, the Company Auditor being the Member of the Institute failing to attend the AGM of the Company, is valid.