Disclaimer Clause : *These solutions are prepared by expert faculty team of Resonance. Views and answers provided may differ from that would be given by ICAI due to difference in assumptions taken in support of the answers. In such case answers as provided by ICAI will be deemed as final.*

Q.1(a)

(i) As per SA 260 "COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE" the auditor shall communicate all significant findings with those charged with governance, namely :

- **(a)** The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;
- **(b)** Significant difficulties, if any, encountered during the audit;
- **(c)** Unless all of those charged with governance are involved in managing the entity :
  - **(i)** Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and
  - **(ii)** Written representations the auditor is requesting; and
- **(d)** Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

Q.1(a)

(ii) As per SA 230 "AUDIT DOCUMENTATION" Form, Content and Extent of Audit Documentation depend on factors such as:

- ❖ The size and complexity of the entity.
- ❖ The nature of the audit procedures to be performed.
- ❖ The identified risks of material misstatement.
- ❖ The significance of the audit evidence obtained.
- ❖ The nature and extent of exceptions identified.
- ❖ The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- ❖ The audit methodology and tools used.

Q.1(b)

(i) The surprise checks constitute an important part of normal audit procedures. Audit procedures cannot consist merely of any set of rules or precepts to be applied to all and every situation but must be allowed to develop in the light of experience with regard to the circumstances of each audit. An element of surprise can significantly improve the effectiveness of an audit and therefore, wherever practicable, an element of surprise should be incorporated into the audit programme. Important recommendations in surprice cheks are as under :

- **(1)** Surprise checks should be considered as a desirable part of each audit.
- **(2)** The areas over which surprise checks should be employed would depend upon the circumstances of each audit but should normally include:
  - **(a)** Verification of cash and investments
  - **(b)** Test-verification of stores and stocks and the records relating thereto
  - **(c)** Verification of books of prime entry and statutory registers normally required to be examined for the purposes of audit.
- **(3)** The frequency of surprise checks may be determined by the auditor in the circumstances of each audit but should normally be at least once in the course of an audit.
- **(4)** The results of the surprise checks should be communicated to the management if they reveal any weakness in the system of internal control or any fraud or error or deficiency in the maintenance of records.
- **(5)** The auditor should satisfy himself that adequate action is taken by the management on the matters communicated by him.
- **(6)** It is not necessary in all cases for the results of the surprise checks to be included in the auditors' report on the accounts. They should, however, be included if in the opinion of the auditor they are material and affect a true and fair view of the accounts on which he is reporting.

Q.1(b)

(ii) Inquiry is one of the audit techniques in applying audit procedures and consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Q.2

(i) Preliminary expenditures are expenditures incidental to the creation and floating of a company and includes stamp duties, registration fees, legal costs, accountant's fees, cost of printing, etc. However underwriting commission and stamp duty on issue of shares and debentures should not be included under the head preliminary expenditure

(ii) Section 224(1) of The Companies Act 1956 provides that an auditor is appointed for a particular period, i.e., from conclusion of one annual general meeting until conclusion of the next annual general meeting. In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded.

(iii) As per AS 2 "Valuation of Inventory" selling and distribution cost are not part of cost of inventory. Therefore it is not correct to include these expenses in cost of inventory.

(iv) Internal check is a part of the overall internal control system and operates as a built-in device as far as the staff organisation and job allocation aspects of the control system are concerned.

A system of internal check in accounting implies organisation of system of book keeping and arrangement of staff duties in such a manner that no one person can completely carry through a transaction and record every aspect thereof.

(v) "Guidance note on accounting for depreciation in companies" issued by the ICAI states that depreciation rate prescribed in schedule XIV of the Companies Act, 1956 are minimum prescribed rates. A company is not permitted to charge depreciation at a lower rate than prescribed under the schedule.

(vi) 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) and the internal control is working without break or lacunae during the period under review.

(vii) As per branch audit exemption rules if a company, carrying on any manufacturing, processing or trading activity, has a branch office whose average of the 'quantum of activity' i.e. (i) the aggregate value of the goods and articles produced, manufactured or processed, or (ii) the aggregate value of the goods or articles sold and of service rendered, or (iii) the amount of the expenditure, whether of a revenue or capital nature, incurred by a branch office of a company during a financial year, does not exceed Rs. 2 lakhs or 2% of the average of the total turnover of the company whichever is higher, the branch office shall be exempted from the provisions of section 228.

Since turnover of the branch in this case is Rs. 1.5 crores i.e. less than Rs. 2 crores, it need not get its accounts audited during the year.

(viii) As per AS 26 "Intangibles" computer software which is integral part of related hardware can be treated as fixed assets.

(ix) CARO 2004 applies to all companies including a foreign company as defined under section 591 of the companies act 1956, except certain categories of companies specifically exempted from the application of the Order.

(x) A transaction in an open and unrestricted market betwen knowledgeable and willing parties under no compulsion to transact is an arm's length transaction.

Q.3(a) **Continuous Audit :** A continuous audit is one in which the auditor's staff is engaged continuously in checking the accounts of the client the whole year round or when for this purpose the staff attends at intervals, fixed or otherwise, during the currency of the financial period. Strictly speaking, when auditor's staff attends the audit work at fixed intervals it may be strictly called interim audit. This is when an audit is conducted up to a particular date within the accounting period. The auditor may attend to audit the figures for a month or for a quarter, as the work may require. It would differ distinctly from the final audit in the extent of the work carried out; verification of assets, for example would be left until the final audit. In case of continuous audit, the work is conducted throughout the course of the financial year but is not taken to a specific accounting period, as is an interim audit. It might be that during the course of the continuous work interim figures are being audited, but the significant factor here is that the auditor will be engaged continuously on the audit throughout the financial period. Staff may be in residence throughout the period or may come and go at irregular intervals, but most of the time, the audit staff is present at the location. Thus, in case of continuous audit, the audit staff is present as the client's premises almost during the entire accounting period.

The disadvantages of a continuous audit can be avoided if the following precautions are taken:

i. During the course of each visit, work should be completed upto a definite stage so as to avoid loose ends.

ii. At the end of each visit, important balances should be noted down and the same should be compared at the time of the next visit.

iii. The visits should be at irregular intervals of time so that the client's staff may not in advance know the exact date when the audit would be resumed and thus may be able to prepare themselves in advance for the same.

iv. The nominal accounts should be checked only at the time of final closing.

v. The client's staff should be instructed not to alter or correct audited figures. The auditor should also device a special form of ticks for being placed against figures which have been altered and neither its purpose nor significance should be disclosed to the client's staff.

Q.3(b) The basic principles govern the auditor's professional responsibilities and should be complied with whenever an audit is carried out. Compliance with the basic principles requires the application of auditing procedures and reporting practices appropriate to the particular circumstances. The basic principles as stated in this guideline are:

I. **Integrity, Objectivity and independence :** The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

II. **Confidentiality :** The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

III. **Skills and Competence :** The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing. The auditor requires specialised skills and competence which are acquired through a combination of general education, knowledge obtained through study and formal courses concluded by qualifying examination recognised for this purpose and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments including pronouncements of the ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.

IV **Work performed by others :** When the auditor delegates work to assistants or uses work performed by other auditors and experts he continues to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, as in the case of the work of branch auditors appointed under the Companies Act, 1956 the auditor's report should expressly state the fact of such reliance. The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditor or experts is adequate for his purpose.

V. **Documentation :** The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

VI. **Planning :** The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. Plans should be made to cover, among other things :

- **(a)** acquiring knowledge of the client's accounting system, policies and internal control procedures
- **(b)** establishing the expected degree of reliance to be placed on internal control;
- **(c)** determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- **(d)** co-ordinating the work to be performed.

Plans should be further developed and revised as necessary during the course of the audit.

VII. **Audit Evidence :** The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information. Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. Substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system. They are of two types :

- **(i)** test of details of transactions and balances; and
- **(ii)** analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.

VIII. **Accounting System and Internal Control :** Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance.

The auditor should gain an understanding of the accounting system and related controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. Where the auditor concludes that he can rely on certain internal controls, his substantive procedures would normally be less extensive than would otherwise be required and may also differ as to their nature and timing.

IX. **Audit conclusions and reporting :** The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether :

- **(a)** the financial information has been prepared using acceptable accounting policies, which have been consistently applied;
- **(b)** the financial information complies with relevant regulations and statutory requirements;
- **(c)** there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Q.4(a) **Planning :** To prepare the audit plan in CIS environment,the auditor should gather the following informations about the CIS environment :

- ❖ How the CIS function is organized and the extent of concentration or distribution of computer processing throughout the entity.
- ❖ The computer hardware and software used by the entity.
- ❖ Each significant application processed by the computer, the nature of the processing (e.g. batch, on-line), and data retention policies.
- ❖ Planned implementation of new applications or revisions to existing applications.

Q.4(b)
(i) **Purchase with invoice :** The purchases on credit should be verified by reference to the suppliers invoices to which generally copies of delivery notes, disclosing the dates and particulars of goods received and acknowledged by the Receiving Department, are also attached. While vouching entries for purchases with the invoices, the following points should be specially observed:

(a) that the date of invoice falls within the accounting period;
(b) that the invoice is made out in the name of the client;
(c) that the supplier's account has been credited with the full amount of the invoice and that the deduction in the amount of the invoice, if any, has been made on a proper basis;
(d) that the goods purchased are those that are regularly dealt in by the concern or required for the processof manufacture carried on by it and that the price has been correctly arrived at;
(e) that the cost of purchases has been debited to an appropriate nominal account or accounts;
(f) that the invoice is signed by the accountant to show that he has verified it as well as the store-keeper to indicate that the delivery of goods have been taken by him. If the invoice relates to the purchase of a technical store or a chemical, a copy of the report of a technical person showing that the article purchased is of the specification for which the order has been placed;
(g) that the official person, competent to sanction payment, has authorised its payment.

Q.4(b)
(ii) **Patterns, Dies, Loose Tools, etc.**

Several entities have large investments in such assets which have a relatively short useful life and low unit cost. Evidently, it is a difficult matter, under the circumstances, to prepare a separate account for each such asset although a careful control over such property is necessary. On these considerations, some entities charge off small tools and other similar items to Production Account as and when they are purchased and do not place any value on the unused stock on the Balance Sheet. Nevertheless, a record of issues and receipts of tools to workmen is kept, as a check on the same being pilfered and a memorandum stock account of dies and patterns is also maintained. In other concerns, the cost of tools, dies, etc. purchased is debited to appropriate assets account, and an inventory of the unused items at the end of the year is prepared and valued; the sum total of opening balance and purchase reduced by the value of closing stock, as disclosed by the inventory, is charged off to Production Account in respect of such assets. On the other hand, some concerns carry such assets at their book values at the end of the first year and charge off the cost of all the purchases in the subsequent year to the Production Account on the plea that they represent cost of replacement.

The most satisfactory method, however, is that of preparing an inventory of serviceable articles, at the close of each year, and revaluing the assets on this basis, the various articles included in the inventory being valued at cost. Care, however, should be taken to see that the inventory does not include any worn out or defective articles the life of which has already run out.

Q.4(b)
(iii) **Work-in-progress :** The auditor may involve a technical expert in verification of work-in-progress if necessary. He may advise his client that where possible the work-in-progress should be reduced to the minimum before the closing date, particularly of items the production of which have been abandoned and for items the manufacture of which is not being actively undertaken provided cost sheets are available in respect of individual items or lots of jobs or work orders, which cannot be identified with physical work, these should be verified as follows :

(a) Ascertain that the cost sheets are duly attested by the Works Engineer and Works Manager.
(b) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost-sheets by reference to the records maintained in respect of issues of materials, payment of wages and its classification and original evidence in respect of all expenditure included in the cost-sheets.
(c) Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimate of cost expected to be maintained under actual operating conditions during a limited future period (wherever these have been developed).
(d) Ensure that the allocation of overhead expenses has been made on reasonable basis and that total of the overhead expenses does not include any amount in respect of selling distribution and office expenses.
(e) Compare the cost-sheet in detail with that of the previous year both in regard to the composition of cost and the value placed on various components. If they vary materially, investigate the causes thereof.

Q.5(a)

(i) Circumstances When a Modification to the Auditor's Opinion Is Required

The auditor shall **modify the opinion** in the auditor's report when:

(a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

(ii) ***Disclaimer of Opinion :*** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

(iii) ***Adverse Opinion :*** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(iv) ***Qualified Opinion :*** The auditor shall express a qualified opinion when:

(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Q.5(b) Special Audit

Section 233 A empowers the Central Government, in certain cases, to call for a 'special audit'.

Such an audit may be required where the Central Government has reasons to believe:

(a) that the affairs of the company are not being managed on sound business principles or according to prudent commercial practices; or

(b) that the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or

(c) that the financial position of the company is such as might endanger its solvency.

Such an audit aims at providing the Government with a critical appreciation of the company and its financial position.

Q.5(c) Verification of Issue of Bonus Shares

Primarily, it should be ascertained whether the Articles permit capitalisation of profits; also whether the company had a sufficient number of unissued shares for allotment as bonus shares. In addition, the following steps should be taken

(a) Inspect the Minute book of Shareholders for the resolution authorising declaration of the Bonus and Director's Minute for the resolution appropriating profits for being applied in payment of shares to be allotted to shareholders as bonus shares;

(b) Trace the allotment of shares as per particulars contained in the Allotment Book or sheets into the Register of Members; and

(c) Confirm that all statutory requirements relevant to the issue of shares have been complied with, viz., the filing of the particulars of the bonus shares allotted with the Registrar together with a copy of the resolution pursuant to which allotment has been made.

(d) Confirm that the issue of fully paid up bonus shares in pursuance of section 205(3) has been kept in abeyance in respect of shares where any instrument of transfer of such shares has been delivered to the company for registration and the transfer of such shares has not been registered by the company. .

(e) Ensure that SEBI Guidelines relating to issue of bonus shares have been complied with. We know that the balances in the Securities Premium Account and Capital Redemption Reserve Account, which are not available for distribution as dividend, can be utilised for allotment of fully paid bonus shares to the members and the balance in the above-mentioned account are usually first utilised for the purpose.

Q.6(a) Audit of a Firm

The auditor to a firm is usually appointed by the partners either on the basis of a decision taken by them or to comply with a condition in the partnership agreement. His remuneration is also fixed by the partners. It is important that the letter of appointment should clearly state the nature and scope of audit which is to be carried out and particulars of limitations, if any, under which he would have to function. The Indian Partnership Act, 1932 does not prescribe audit of a partnership firm. Nevertheless, for the verification of adjustment in the accounts of partners made in respect of profits and losses, interest and remuneration of partners, their contribution to capital, etc. It is necessary that the auditor should have a knowledge of the provisions in this regard under the Act—especially that of powers and audit of partners and their right to profit and capital under different situations and circumstances. The auditor may, particularly, ensure application of accounting standards prescribed by the Institute. In case the firm is required to get its accounts audited under the requirements of any statute, the auditor will have to qualify the report in case of noncompliance with the accounting standards. Alternatively, only disclosure of non-compliance with the accounting standards, would be sufficient without making it a subject matter of qualification. Also, before starting the audit, he should examine the partnership agreement and note the provisions therein as regards the following matters :

(1) The name and style under which the business shall be conducted.

(2) The duration of the partnership, if any, that has been agreed upon.

(3) The amount of capital that shall be contributed by each partner—whether it will be fixed or could be varied from year to year.

(4) The period at the end of which the accounts of the partnership will be closed periodically and the proportions in which the profit shall be divided among the partners or losses shall have to be contributed by them; whether the losses shall be borne by the partners or whether any of the partners will not be required to do so.

(5) The provisions as regards maintenance of books of account and the matters which must be taken into account for determining the profits of the firm available for division among the partners *e.g.*, creation of reserves, provision for depreciation, etc. also the period within which accounts can be reopened for correcting a manifest error.

(6) Borrowing capacity of the partnership (when it is not implied as in the case of non-trading firms).

(7) The rate at which interest will be allowed on the capitals and loans provided by partners and the rate at which it will be charged on their drawings and current accounts.

(8) Whether any salaries are payable to the partners or withdrawals are permitted against shares of profits and, if so, to what extent ?

(9) Duties of the partners as regards the management of business of the firm; also, the partners who shall act as managing partners.

(10) Who shall operate the bank account of the firm ? How will the surplus funds of the partnership be invested ?

(11) Limitations and restrictions that have been agreed upon the rights and powers of partners and on their implied authority to pledge the firm’s credit or to render it liable

Q.6(b) Provisions Relating to Audit

The auditors of an NGO registered under the Societies Registration Act, 1860 (or under any law corresponding to this Act, in force in any part of India) or the Indian Trusts Act 1882 are normally appointed by the Management of the Society or Trust. The auditors of NGO registered under section 25 of the Companies Act, 1956 are appointed by the members of the company. Some of the statues such as the Companies Act, 1956, Foreign Contribution (Regulation) Act 1976, Income Tax Act 1961 required that the accounts of the NGO be audited and submitted to the prescribed authorities and failure to do so could lead to forfeiture of certain exemptions and benefits. In the case of NGO/PDA’s different statutes have specified certain audit reports. The Foreign Contribution (Regulation) Act 1976 has prescribed the format and requires that the same be furnished to the Ministry of Home Affairs within 60 days from the close of the financial year i.e. by May 30 each year.

While planning the audit, the auditor may concentrate on the following:

(i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.

(ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.

(iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.

(iv) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.

(v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.

(vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

(vii) Setting of materiality levels for audit purposes.

(viii) The nature and timing of reports or other communications.

(ix) The involvement of experts and their reports.

(x) Review the previous year's Audit Report.

Q.7(i) Audit Planning and Materiality

The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for:

(a) Determining the nature, timing and extent of risk assessment procedures;

(b) Identifying and assessing the risks of material misstatement; and

(c) Determining the nature, timing and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. Although, it is not practicable to design audit procedures to detect misstatements that could be material solely because of their nature, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.3

When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

Q.7(ii) Impairment of assets :

Besides charging annual depreciation on assets by the reason ofnormal wear and tear, afflux ion of time and obsolescence to re-instate the correct value of the assets considering the future cash flows that the assets can generate, impairment loss needs to be provided. The difference between the carrying amount of an asset and recoverable amount is termed as impairment loss. The treatment of impairment loss is similar to depreciation except the fact that it can be re-instated in future, if the recoverable amount of the asset exceeds the carrying amount.

The auditor must ensure that provisions of AS 28 "Impairment of assets" are followed.

Q.7(iii) Internal Control Questionnaire

This is a comprehensive series of questions concerning internal control. This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation.

An important advantage of the questionnaire approach is that oversight or omission of significant internal control review procedures is less likely to occur with this method. With a proper questionnaire, all internal control evaluation can be completed at one time or in sections. The review can more easily be made on an interim basis. The questionnaire form also provides an orderly means of disclosing control defects. It is the general practice to review the internal control system annually and record the review in detail. In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness. Provision is made for an explanation or further details of 'No' answers. In respect of questions not relevant to the business, 'Not Applicable' reply is given.

The questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees. If on a perusal of the answers, inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditor's staff with the client's employees for a clear picture. The concerned auditor then prepares a report of deficiencies and recommendations for improvement.

Q.7(iv) Letter of Weakness

(1) 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.

(2) When he comes across any weakness in the control points, he issues letter of weakness.

(3) 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.

(4) Lapses in operation of internal control too are reported in the communication of weakness.

(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 it should not be taken to be a review and comment on adequacy of the control mechanism for management purpose.

Q7(v) Assertions about account balances at the period end :

(i) Existence—assets, liabilities, and equity interests exist.

(ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

(iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.

(iv) Valuation and allocation—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.