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PAPER – 6 : AUDITING AND ASSURANCE

*Question No.**1** is compulsory.*

*Attempt any **five** questions from the remaining six questions.*

Question 1

Discuss the following:

(a) Advantages of independent audit. *(5 Marks)*

(b) The auditor's report is considered to be modified under certain circumstances. *(5 Marks)*

(c) Is detection of fraud and error duty of an auditor? *(5 Marks)*

(d) Mention any four information which assists the auditor in accepting and continuing of relationship with the client as per SA 220. *(5 Marks)*

Answer

(a) Advantages of Independent Audit: The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below-

(i) It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders.

(ii) It acts as a moral check on the employees from committing defalcations or embezzlement.

(iii) Audited statements of account are helpful in settling liability for taxes, negotiating loans and for determining the purchase consideration for a business.

(iv) These are also useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property by fire or some other calamity.

(v) An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked especially those that occur due to the absence or inadequacy of internal checks or internal control measures.

(vi) Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.

(vii) As an appraisal function, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them.

(viii) Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.

(ix) Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.

(b) Modified Report: An auditor's report is considered to be modified when it includes -

(A) Matters That Do Not Affect the Auditor's Opinion

(i) **Emphasis of Matter paragraph:** Sometimes the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.

(ii) **Other Matter paragraph:** If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter", or other appropriate heading.

(B) Matters that Do Affect the Auditor's Opinion

(i) Qualified Opinion: The auditor shall express a qualified opinion when-

(1) 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

(2) 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.

(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.

(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.

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

(1) The auditor concludes that, based on the audit evidence obtained, the financial

statements as a whole are not free from material misstatement; or

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

(c) Detection of Fraud and Error - Duty of an Auditor: As per SA-240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behaviour which can be reinforced by an active oversight by those charged with governance. In exercising oversight responsibility, those charged with governance consider the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability. Broadly, the general principles laid down in this regard are:

(i) An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. As described in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.

(ii) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.

(iii) Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

(iv) When obtaining reasonable assurance, the auditor is responsible for maintaining an attitude of professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

It may be concluded from the above that detection of fraud and error is not the duty of the auditor provided that he complies with the requirements given in Standards on Auditing, maintains professional skepticism throughout the audit and is not grossly negligent in the performance of his duties as an auditor.

(d) **Information which assist the Auditor in accepting and continuing of relationship with Client:** As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

(i) The integrity of the principal owners, key management and those charged with governance of the entity;

(ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;

(iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and

(iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Question 2

*State with reasons (in short) whether the following statements are correct or incorrect: (Answer any **eight**)*

(i) C & AG orders to conduct test audit of the accounts of a Government company.

(ii) The auditor shall not modify the opinion in the auditor's report.

(iii) The first auditor of a Government company was appointed by the Board in its meeting after 10 days from the date of registration.

(iv) As per section 138 of the Companies Act, 2013 private companies are not required to appoint internal auditor.

(v) Written representation by management as to the quality of inventory is substitute for verification.

(vi) Letter of weakness is issued by the Management.

(vii) Scrutiny of Bank Reconciliation statement is one of the audit techniques.

(viii) The basic objective of audit does not change with reference to nature, size or form of an entity.

(ix) Director's relative can act as an auditor of the company.

(x) If an LLP (Limited Liability Partnership Firm) is appointed as an auditor of a company, every partner of a firm shall be authorized to act as an auditor. (8 x 2 = 16 Marks)

Answer

(i) Correct: Comptroller and Auditor- General of India may, in case of a government company, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company.

(ii) Incorrect: The auditor shall modify the opinion in the auditor's report when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

(iii) Incorrect: According to section 139(7) of the Companies Act, 2013, in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. If CAG fails to make the appointment within 60 days, the Board shall appoint in next 30 days.

(iv) Incorrect: Section 138 of the Companies Act, 2013 requires every private company to appoint an internal auditor having turnover of ₹ 200 crore or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding ₹ 100 crore or more at any point of time during the preceding financial year.

(v) Incorrect: Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership) and in identifying its quality for example, obsolete, damaged or ageing inventory. Written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

<u>Alternative Reason for incorrect answer may be given as</u>: One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

(vi) Incorrect: 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 to be corrected and the control system be made better protected.

(vii) Correct: For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. The scrutiny of Bank

Reconciliation Statement is one of the Audit techniques commonly adopted by the auditors.

(viii) Correct: An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

(ix) Incorrect: As per section 141(3) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel.

(x) Incorrect: As per section 141(2) of the Companies Act, 2013, where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorised to act and sign on behalf of the firm.

Question 3

How will you vouch/verify the following?

(a) Rental Receipts

(b) Repair to assets

(c) Work-in-progress

(d) Insurance claims. *(4 x 4 = 16 Marks)*

Answer

(a) Rental Receipts:

(i) Check copies of bills or rent receipts issued to the tenant with reference to tenancy agreement and bills of charges paid by the landlord on behalf of tenants.

(ii) The entries in the rental register in respect of rent accrued should be traced with reference to copies of rental bills.

(iii) Scrutinize the account of collecting agent when the rent is collected by such agent.

(iv) Vouch the entries for rent received in advance and ensure proper adjustment is made.

(v) Investigate abnormal rent outstanding, if any.

(vi) Reconcile the outstanding rent and check that proper provision is made if unrecoverable.

(vii) If rent is received net of TDS, check that the rental income is shown at gross amount and TDS is shown in Balance Sheet as per Schedule III to the Companies Act, 2013.

(b) Repair to Assets:

(i) Since the line demarcating repairs from renewals is slender, usually it is not a simple matter to determine the amount of the expenditure, if any, included as charges for repairs, which should be considered as that incurred for renewal of an asset and added to its cost.

(ii) It may sometimes be possible to determine this on a consideration of the nature of repairs carried out. The proportion of the charges which had the effect of increasing the value of an asset or enhancing its capacity or life should be treated as capital expenditure.

(iii) Where, however, it is not possible to form an opinion accurately on the basis of evidence as regards the nature of repairs, a certificate from the engineer under whose supervision the repairs were carried out, confirming the classification of expenditure should be obtained.

(iv) It should be ensured that Repairs to 'Certain Assets' like Building and Machinery have been separately disclosed as per the requirements of Schedule III to the Companies Act, 2013.

(c) Work in Progress:

(i) Involve a technical expert in verification and valuation of WIP, if necessary.

(ii) Ensure that cost sheets are duly attested by the works manager.

(iii) 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.

(iv) Verify stage of completion with component of cost involved with underlying records.

(v) Compare the unit cost as shown by the cost sheet with standard cost for any large variations.

(vi) Ensure that the allocation of overhead expenses has been made on reasonable basis and is same as used in earlier period.

(vii) Compare the cost sheet with that of the previous year and if there is any large variation, investigate the reason thereof.

(d) Insurance Claims: While vouching the receipts of insurance claims, following points may be considered-

(i) The auditor should examine a copy of the insurance claim lodged with the insurance company. Correspondence with the insurance company and with the insurance agent should also be seen. Counterfoils of the receipts issued to the insurance company should also be seen.

(ii) The auditor should also determine the adjustment of the amount received in excess or short of the value of the actual loss as per the insurance policy.

(iii) The copy of certificate/report containing full particulars of the amount of loss should also be verified.

(iv) The accounting treatment of the amount received should be seen particularly to ensure that revenue is credited with the appropriate amount and that in respect of claim against asset, the profit and loss account is debited with the short fall of the claim admitted against book value.

(v) If the claim was lodged in the previous year but no entries were passed, entries in the profit and loss account should be appropriately described.

Question 4

(a) State the significant difficulties encountered during audit with reference to SA-260 (communication with those charged with governance). *(6 Marks)*

(b) The auditor may exercise his judgement to identify which risks are significant risks. Explain the above in context of SA-315. *(6 Marks)*

(c) State the manner of rotation of auditors on expiry of their term. *(4 Marks)*

Answer

(a) Significant Difficulties Encountered During the Audit: As per SA 260 "Communication with Those Charged with Governance", significant difficulties encountered during the audit may include such matters as:

- Significant delays in management providing required information.
- An unnecessarily brief time within which to complete the audit.
- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- The unavailability of expected information.
- Restrictions imposed on the auditor by management.
- Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

(b) Identification of Significant Risks: SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following-

(i) Whether the risk is a risk of fraud;

(ii) Whether the risk is related to recent significant economic, accounting or other developments like changes in regulatory environment etc. and therefore requires specific attention;

(iii) The complexity of transactions;

(iv) Whether the risk involves significant transactions with related parties;

(v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

(vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.

(c) Manner of Rotation of Auditors on Expiry of their Term: Prescribed manner of rotation of auditors on expiry of their term is given below-

(1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.

(2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

(3) For the purpose of the rotation of auditors-

(i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;

(ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

The term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Further, for the purpose of rotation of auditors,-

(a) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;

(b) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

(4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

Question 5

(a) Audit documentation serves a number of purposes. Explain with reference to SA-230.

(6 Marks)

(b) Explain the inherent limitations of Internal Control. *(6 Marks)*

(c) Point out any eight areas where external confirmation used as an audit procedure.

(4 Marks)

Answer

(a) Audit Documentation: As per SA 230 “Audit Documentation”, audit working papers are the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached.

(i) Working papers are the evidence of the auditor’s basis for a conclusion about the achievement of the overall objective of the auditor and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

(ii) Assisting the engagement team to plan and perform the audit.

(iii) Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.

(iv) Enabling the engagement team to be accountable for its work.

(v) Retaining a record of matters of continuing significance to future audits.

(vi) Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.

(vii) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

(b) Inherent Limitations of Internal Control: The following are the inherent limitations of Internal Control -

(i) Management's consideration that cost of an internal control does not exceed the expected benefits.

(ii) Most controls do not tend to be directed at unusual transactions.

(iii) The potential of human error due to carelessness, misjudgment and misunderstanding of instructions.

(iv) The possibility that control may be circumvented through collusion with employees or outsiders.

(v) The possibility that a person responsible for exercising control may abuse that authority.

(vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.

(vii) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

(viii) Inherent limitations of Audit.

(c) External Confirmation as an Audit Procedure: SA 505, "External Confirmations", lays down standards for external confirmation of balances. External confirmations are frequently used in relation to account balances and their components but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements or transactions an entity has with third parties. The confirmation request is designed to ask if any modifications have been made to the agreement, and if so, the relevant details thereof. Other areas where external confirmations may be used include the following:

- Bank balances and other information from bankers.
- Accounts receivable balances.
- Inventories held by third parties.
- Property title deeds held by third parties.
- Investments purchased but delivery not taken.
- Loans from lenders.
- Accounts payable balances.
- Long outstanding share application money.

Question 6

(a) What are the advantages of the audit of the accounts of a partnership firm? (6 Marks)

(b) What are the objectives and functions of Auditing and Assurance Standards Board (AASB)? Explain. (6 Marks)

(c) State the important objectives of local body's audit. (4 Marks)

Answer

(a) Advantages of audit of accounts of a partnership firm: The following are the advantages of audit of accounts of partnership firm -

(i) Audited accounts provide a convenient and reliable means of settling accounts between the partners and thereby possibility of dispute among them is mitigated.

(ii) On the retirement/death of a partner, audited accounts constitutes a reliable evidence for computing the amount due to the retiring partner or representative of deceased partner.

(iii) Audited accounts are generally accepted by the Income tax authorities for computing the assessable income.

(iv) Audited accounts are relied upon by banks for advancing loan.

(v) Audited accounts can be helpful in the negotiation for sale or admission of a new partner.

(vi) It is an effective safeguard against any undue advantage being taken by a working partner as against the non working partners.

(b) Objectives and Functions of the Auditing and Assurance Standards Board: The following are the objectives and functions of the Auditing and Assurance Standards Board-

(i) To review the existing and emerging auditing practices worldwide and identify areas in which Standards on Quality Control, Engagement Standards and Statements on Auditing need to be developed.

(ii) To formulate Engagement Standards, Standards on Quality Control and Statements on Auditing so that these may be issued under the authority of the Council of the Institute.

(iii) To review the existing Standards and Statements on Auditing to assess their relevance in the changed conditions and to undertake their revision, if necessary.

(iv) To develop Guidance Notes on issues arising out of any Standard, auditing issues pertaining to any specific industry or on generic issues, so that those may be issued under the authority of the Council of the Institute.

(v) To review the existing Guidance Notes to assess their relevance in the changed circumstances and to undertake their revision, if necessary.

(vi) To formulate General Clarifications, where necessary, on issues arising from Standards.

(vii) To formulate and issue Technical Guides, Practice Manuals, Studies and other papers under its own authority for guidance of professional accountants in the cases felt appropriate by the Board.

(c) Objectives of Audit of Local Bodies: The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. The municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit. The important objectives of audit are-

(i) reporting on the fairness of the content and presentation of financial statements;

(ii) reporting upon the strengths and weaknesses of systems of financial control;

(iii) reporting on the adherence to legal and/or administrative requirements;

(iv) reporting upon whether value is being fully received on money spent; and

(v) detection and prevention of error, fraud and misuse of resources.

Question 7

*Write short notes on any **four** of the following:*

(a) Fundamental Accounting Assumptions.

(b) Methods to obtain audit evidence.

(c) Importance of working papers.

(d) Random sampling.

(e) Defalcation of cash with examples. *(4 x 4 = 16 Marks)*

Answer

(a) Fundamental Accounting Assumptions: AS 1 states that certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed. The following have been generally accepted as fundamental accounting assumptions:

(1) Going Concern: The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

(2) Consistency: It is assumed that accounting policies are consistent from one period to another.

(3) **Accrual:** Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

Thus, if the fundamental accounting assumptions, viz., Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

(b) Methods of Obtaining Audit Evidence: The auditor obtains evidence by one or more of the following methods -

Inspection: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of control is inspection of records for evidence of authorisation.

Observation: Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

External Confirmation: An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only.

Recalculation: Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Reperformance: Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures: Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

Inquiry: Inquiry 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.

(c) Importance of Working Papers: Working papers are very useful to the auditor as discussed below-

(i) It provides guidance to the audit staff with regard to manner of checking the schedules.

(ii) The auditor is able to fix responsibility on the staff members who signs each schedule.

(iii) It acts as an evidence in the court of law when a charge of negligence is brought against the auditor.

(iv) It acts as the process of planning for the auditor so that he can estimate the time that may be required for checking the schedules.

(d) Random Sampling: Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables. Random sampling includes two very popular methods which are discussed below–

(i) **Simple random sampling:** Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. The mechanics of selection of items may be by choosing numbers from table of random numbers by computers or picking up numbers randomly from a drum. It is considered that random number tables are simple and easy to use and also provide assurance that the bias does not affect the selection. This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range. For example the population can be considered homogeneous, if say, trade receivables balances fall within the range of ₹ 5,000 to ₹ 25,000 and not in the range between ₹ 25 to ₹ 2,50,000.

(ii) **Stratified Sampling:** This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment. For example in the above case, trade receivables balances may be divided into four groups as follows -

(a) balances in excess of ₹ 1,00,000;

(b) balances in the range of ₹ 75,000 to ₹ 1,00,000;

(c) balances in the range of ₹ 25,000 to ₹ 75,000; and

(d) balances below ₹ 25,000.

(e) **Defalcation of Cash:** Defalcation of cash has been found to perpetrate generally in the following ways -

(i) By inflating cash payments.

Examples of inflation of payments:

(1) Making payments against fictitious vouchers.

(2) Making payments against vouchers, the amounts whereof have been inflated.

(3) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.

(4) Casting a larger totals for petty cash expenditure and adjusting the excess in the totals of the detailed columns so that cross totals show agreement.

(ii) By suppressing cash receipts. Few Techniques of how receipts are suppressed are:

(1) Teeming and Lading: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. Similarly, money received from the customer who has paid thereafter being credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time, which may lead the management to either send out a statement of account to him or communicate with him.

(2) Adjusting unauthorised or fictitious rebates, allowances, discounts etc. to customer' accounts and misappropriating amount paid by them.

(3) Writing off as debts in respect of such balances against which cash has already been received but has been misappropriated.

(4) Not accounting for cash sales fully.

(5) Not accounting for miscellaneous receipts e.g. sale of scrap, quarters allotted to the employees etc.

(6) Writing down asset values in entirety, selling them subsequently and misappropriating the proceeds.

(iii) By casting wrong totals in the cash book.