Audit Strategy, Planning and Programming

Question 1

You have been appointed as the statutory auditor of a private limited company for the first time. Apart from adopting the conventional audit procedures such as posting, casting and vouching, what other auditing techniques would you employ for conducting the statutory audit?

Answer

A statutory auditor conducting audit of a private company for the first time would do well in case he obtains knowledge of the business of the company to understand and assess the kind of audit procedures to be employed by him as per SA 315 and SA 330 “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment” and “The Auditor’s Responses to Assessed Risks” respectively. Knowledge of the business is a frame of reference within which the auditor exercises professional judgement. Understanding the business and using this information appropriately assists the auditor in:

(i) Assessing risks and identifying problems.
(ii) Planning and performing the audit effectively and efficiently.
(iii) Evaluating audit evidence.

Such knowledge would enable the auditor to identify and understand the events, transactions and practices that, in the auditor’s judgement, may have a significant effect on the financial statements or on the examination or audit report. As far as adoption of conventional audit procedures is concerned, it would normally involve lot of time without commensurate benefits. In any case, if size of the business is large, the application of conventional procedure would involve extraordinary more time resulting into more cost and even then the auditor would not get the required satisfaction as to the figures contained in the financial statements. There may however, be some instances, say, where internal control systems are quite weak, it may perhaps be advisable to stick to conventional audit procedures such as vouching, etc. in detail. In any case, application of compliance procedure to evaluate the internal control systems in operations would enable the auditor to determine nature, extent and timing of substantive procedures.

Depending upon various factors including size of the business, it is advisable to reduce the extent of checking by adopting test check approach. Test-check approach is an accepted auditing procedure, which aims to test transactions on the basis of selection of samples from
the entire population. Audit sampling means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population. It is important to recognise that certain testing procedures do not come within the definition of sampling. Tests performed on 100% of the items within a population do not involve sampling. Likewise, applying audit procedures to all items within a population which have a particular characteristic (for example, all items over a certain amount) does not qualify as audit sampling with respect to the portion of the population examined, nor with regard to the population as a whole, since the items were not selected from the total population on a basis that was expected to be representative. Such items might imply some characteristic of the remaining portion of the population. The auditor would also consider the specific audit objectives to be achieved and the audit procedures which are likely to best achieve those objectives. In addition, when audit sampling is appropriate, consideration of the nature of the audit evidence sought and possible error conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes an error and what population to use for sampling. For example, when performing tests of control over an entity's purchasing procedures, the auditor will be concerned with matters such as whether an invoice was clerically checked and properly approved. On the other hand, when performing substantive procedures on invoices processed during the period, the auditor will be concerned with matters such as the proper reflection of the monetary amounts of such invoices in the financial statements.

After performing vouching, it is necessary for an auditor to perform verification of balances contained in the financial statements. Verification and valuation of assets and liabilities contained in the balance sheet would involve obtaining evidence through methods like physical observations, confirmation, computation, inspection of documents and analytical reviews. Direct confirmation procedure provides an independent audit evidence to analyse the financial information contained in the accounting records. For example, confirmation may be done for trade receivables, trade payables, investments lying with third parties, bank balances, etc.

Apart from conducting audit procedures like vouching and verification, it is quite useful to employ analytical review procedures; In fact, analytical review procedures would provide substantive audit evidence to support various assertions in the financial statements. Over a period of time, the analytical review as a method of obtaining evidence has emerged as a significant auditing procedures. As per SA 520, analytical procedures means the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts. Analytical procedures in planning the audit use both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold. The auditor's reliance on substantive procedures to reduce detection risk relating to specific financial statement assertions may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedures to use to achieve a particular audit objective is based on the auditor's judgement about the expected effectiveness and efficiency of the available procedures in reducing detection risk for specific financial statement assertions. It further states that when
analytical procedures identify significant fluctuations or relationships that are inconsistent with other relevant information or that deviate from predicted amounts, the auditor should investigate and obtain adequate explanations and appropriate corroborative evidence.

Therefore, a statutory auditor who has been appointed for the first time must resort to evaluation of internal control system through performance of compliance procedures based on the knowledge of the client’s business followed by vouching on a selected basis having regard to sampling. Physical observation and direct confirmation are also useful audit techniques in the verification of items contained in the financial statements. Ratio analysis or analytical procedures would also provide audit evidence as to various assertions contained in the financial statements.

Question 2

Write short notes on the following:

(a) Walk through Tests
(b) Cut-off Procedures.

Answer

(a) Walk through Tests: A walk through is a procedure in which an auditor traces a transaction from its initiation through the company’s information systems to the point when it is reflected in the financial reports. The auditor should perform one walk through, at a minimum, for each major class of transactions. A walk-through provides evidence to confirm that the auditor understands (1) the process flow of transactions, (2) the design of identified controls for internal control components, including those related to preventing and detecting fraud, and (3) whether all points in the process have been identified at which misstatements related to relevant financial statement assertion could occur. Walk through also provide evidence to evaluate the effectiveness of the controls’ design and confirm that the controls have been placed in operation.

When performing a walk-through, the auditor should:

(i) Be sure that the walk-through encompasses the complete process (initiation, authorization, recording, processing and reporting) for each significant process identified, including controls intended to address fraud risk.

(ii) Ask the entity’s personnel, at each of key stage in the process, about their understanding of what the company’s prescribed procedures require.

(iii) Determine whether processing procedures are performed as expected on a timely basis, and look for any exceptions to prescribed procedures and controls.

(iv) Evaluate the quality of evidence provided and perform procedures that produce a level of evidence consistent with the auditor’s objectives. The auditor should follow the whole process, using the same documents and technology that company staff use, asking questions of different personnel at each significant stage and asking follow-up questions to identify any abuse of controls or fraud indicators.
Once a walk-through is performed, the auditor may carry forward the documentation, noting updates, unless significant changes make preparation of new documentation more efficient. If such significant changes occur in the process flow of transactions or supporting computer applications, the auditor should evaluate the nature of changes and the effect on related accounts. The auditor should determine whether it is necessary to walk through transactions that were processed both before and after the change.

(b) **Cut-off Procedures**: Cut-off procedures mean procedures employed to ensure the separation of transactions at the end of one year from those in the commencement of the next year. Usually, the problem of overlapping is found in inventory accounting since quite often goods are sold but passed on to the buyer only after the year is over or goods are bought but received only after the close of the year. This situation may create considerable problem for the proper stock taking of inventory. Therefore, the principal areas of application of cut-off procedures involve sales, purchases and stock. The auditor should satisfy himself by examination and test check that these procedures adequately ensure that:

(i) Goods purchased for which property has passed to the client have in fact been included in inventories and that the liability if any, has been provided for.

(ii) Goods sold have been excluded from the inventories and credit has been taken for sales.

The auditor may examine a sample of documents evidencing the movement of stocks into and out of stores, including documents pertaining to period shortly before and shortly after the cut-off date, and check whether the stocks represented by those documents were included or excluded, as appropriate, during the stock-taking.

**Question 3**

*Designing an Audit Strategy is the backbone of the “Audit Planning” process. Discuss.*

**Answer**

Audit strategy is concerned with designing optimised audit approaches that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available. The formulation of audit strategy as shall be evident from the process as explained in the following paragraphs in fact shall form the basis of audit planning to achieve the audit objectives in the most efficient and effective manner. Audit strategy generally involves the following steps:

(i) **Obtaining Knowledge of Business**: SA 315 and SA 330 “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment” and “The Auditor’s Responses to Assessed Risks” respectively states that in performing an audit of financial statements, the auditor should have or obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditor’s judgement, may have a significant effect on the financial statements or on the examination or audit report. Knowledge of the business is a frame of reference within which the auditor exercises professional judgement. Understanding the business and using this information appropriately assists
the auditor in assessing risks and identifying problems, planning and performing the audit effectively and efficiently. It also ensures that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to enable them to carry out the audit work delegated to them. This would also ensure that the audit staff understands the need to be alert for additional information and the need to share that information with the auditor and the other audit staff.

(ii) Performing Analytical Procedures: The purpose of analytical procedures at the planning stage is attention-directing; corroboration is not normally necessary at this stage. The use of the analytical procedures during the planning stage requires the extensive use of accounting and business knowledge and experience to assess the potential for material misstatement in the financial statements as a whole, because the key aspect of the task is to identify the relevant risk indicators and to interpret them properly. Furthermore, analytical techniques applied during the planning stage are not generally as precise as the analytical techniques at the substantive stage.

(iii) Evaluating Inherent Risk: To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors such as quality of accounting system, unusual pressure on management, etc. having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which, might have taken place since his last assessment.

(iv) Evaluating Internal Control: The auditor’s assessment of the control environment is crucial to the decision on whether to make an extended assessment of controls. This is because a good control environment is conducive to the maintenance of a reliable system of accounting and control procedures. For strategy purposes, the auditor should obtain a sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the audit strategy will involve an extended assessment of internal accounting controls. This is done by:

(a) considering the results of gathering or updating information about the client; and

(b) making preliminary judgements about materiality, inherent risk and control effectiveness. These will include identification of the system(s) the auditor proposes to subject to an extended assessment of controls.

Thus, the audit strategy is evolved after considering the engagement objectives, the results of the business review, preliminary judgements as to materiality and identified inherent risks. Audit strategy also considers main points relating to planning and controlling the audit or comments on adequacy of the existing arrangements. Thus, the overall audit plan involving determination of timing, manpower, coordination and the directions in which the audit work has to proceed is dependent upon the audit strategy formulated by the audit firm.

Question 4

X Ltd., paid ₹ 25 lakhs as advance to Y Ltd. towards the purchase of a printing machinery on 15.1.15 with delivery instructions to deliver the same in the last week of June, 15. Further, on 2.2.15 X Ltd. purchased two diesel generator sets from Y Ltd. for ₹ 30 lakhs on 90 days Credit
term. In the accounts for 2015-16, X Ltd. intends to adjust the advance paid against Credit purchase and show the net amount of ₹ 5 lakhs as due from them. As the statutory auditor, how would you deal with this?

**Answer**

Since X Ltd. has paid advance amount to the supplier of machinery to be used in the project, such advance amount should be grouped under the head ‘Capital Work in Progress’. This is as per requirement of Schedule III to the Companies Act, 2013 and the existing accounting practice.

If the advance is for purchase of other machinery, it should be grouped under a separate head – say ‘Advance Payment for Capital Expenditure’ and should be disclosed as next item to Fixed Assets in the Balance Sheet.

In view of the above, the proposal of X Ltd., to show the net balance in the personal account of Y Ltd., is not correct. Such proposal will conceal the two material items in the balance sheet – one, expenditure towards capital asset and the other current liability for purchase of the generator set.

Hence, the auditor should advise X Ltd., to show these two items separately. If X Ltd. does not accept the advice, the auditor should qualify his report with suitable quantification of amount involved.

**Question 5**

**Answer the following:**

(a) What are the considerations to be kept in mind while performing analytical procedures on data prepared by the client?

(b) You have been appointed as the auditor of a Multiplex Cinema House. Draw an audit programme in respect of its Revenue and Expenditure.

**Answer**

(a) As per “SA 520 (Revised) Analytical Procedure”, when the auditor intends to perform analytical procedures on data prepared by the client, he should consider the following:

(i) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;

(ii) Evaluate the reliability of data from which the auditor’s expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;

(iii) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
(iv) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation and if analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

1. Inquiring of management and obtaining appropriate audit evidence relevant to management’s responses; and
2. Performing other audit procedures as necessary in the circumstances.

(b) Audit Programme of Multiplex

(i) Peruse the Memorandum of Association and Articles of Association of the entity.

(ii) Ensure the object clause permits the entity to engage in this type of business.

(iii) In the case of income from sale of tickets:

1. Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
2. Verify the system of relating to online booking of various shows and the system of realization of money.
3. Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.

(iv) Verify the internal control system and its effectiveness relating to the income from cafe shops, pubs etc., located within the multiplex.

(v) Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.

(vi) Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.

(vii) In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.

(viii) Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.

(ix) Verify the payments effected in respect of the maintenance of the building and ensure the same is in order.

Question 6

What are the points to be considered while evaluating the “Knowledge of the Business” in the conduct of an audit?
Answer

The broad matters to be considered while obtaining knowledge of business for a new audit assignment are set out in SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment. These are:

(i) Relevant industry, regulatory, economic and other external factors including the applicable financial reporting framework.

(ii) The nature of the entity, including:

   (1) its operations;
   (2) its ownership and governance structures;
   (3) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
   (4) the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.

(iii) The entity’s selection and application of accounting policies.

(iv) The entity’s objectives and strategies, and those related business risks that may result in risks of material misstatement.

(v) The measurement and review of the entity’s financial performance.

In addition to the importance of knowledge of the client’s business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgement regarding the appropriateness of accounting policies and disclosures.

Question 7

A & Co. was appointed as auditor of Great Airways Ltd. As the audit partner what factors shall be considered in the development of overall audit plan?

Answer

Development of an overall plan - Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:

(i) Terms of his engagement and any statutory responsibilities.

(ii) Nature and timing of reports or other communications.

(iii) Applicable Legal or Statutory requirements.

(iv) Accounting policies adopted by the clients and changes, if any, in those policies.

(v) The effects of new accounting and auditing pronouncement on the audit.
2.9 Advanced Auditing and Professional Ethics

(vi) Identification of significant audit areas.
(vii) Setting of materiality levels for the audit purpose.
(viii) Conditions requiring special attention such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
(ix) Degree of reliance to be placed on the accounting system and internal control.
(x) Possible rotation of emphasis on specific audit areas.
(xi) Nature and extent of audit evidence to be obtained.
(xii) Work of the internal auditors and the extent of reliance on their work, if any in the audit.
(xiii) Involvement of other auditors in the audit of subsidiaries or branches of the client and involvement of experts.
(xiv) Allocation of works to be undertaken between joint auditors and the procedures for its control and review.
(xv) Establishing and coordinating staffing requirements.

Question 8

XY Ltd. is a manufacturing company, provided following details of wastages of raw materials in percentage, for various months. You have been asked to enquire into causes of abnormal wastage of raw materials. Draw out an audit plan.

<table>
<thead>
<tr>
<th>Month</th>
<th>Wastage Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2016</td>
<td>1.5%</td>
</tr>
<tr>
<td>Aug 2016</td>
<td>1.7%</td>
</tr>
<tr>
<td>Sep 2016</td>
<td>1.4%</td>
</tr>
<tr>
<td>Oct 2016</td>
<td>4.1%</td>
</tr>
</tbody>
</table>

Answer

Audit Plan to locate the Abnormal Wastage of Raw Material: To locate the reasons for the abnormal wastage, the auditor should first of all assess the general requirements as under:

(i) Procure a list of raw materials, showing the names and detailed characteristics of each raw material.

(ii) Obtain the standard consumption figures, and ascertain the basis according to which normal wastage figures have been worked out. Examine the break-up of a normal wastage into that in process, storage and handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.

(iii) Examine the various records maintained for recording separately the various lots purchased and identification of each lot with actual material consumption and for ascertaining actual wastage figures therein.
(iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrappage work.

(v) Assess whether personnel employed are properly trained and working efficiently.

(vi) See whether quality control techniques have been consistent or have undergone any change.

(vii) Examine inventory plans and procedures in report of transportation storage efficiency, deterioration, pilferage and whether the same are audited regularly.

(viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months.

(ix) Obtain a statement showing break up of wastage figures in storage, handling and process for the four months under reference and compare the results of the analysis for each of the four months.

In addition, some specific reasons for abnormal wastage in process may be considered by the auditor are as under:

(i) Examine laboratory reports and inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.

(ii) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.

(iii) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors’ reports in respect of inspection carried out on the completion of each stage of work or process.

(iv) It is possible that the wastage may have occurred because the particular lot out of which issues were made was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures.

(v) Abnormal wastage in storage and handling may arise due to the following reasons:

1. Write offs on account of reconciliation of physical and book inventories: In case of periodical physical inventory taking, such write offs will be reflected only in the month such reconciliation takes place.

2. Accidental, theft or fire losses in storage: The auditor should examine the possibility of these for the purpose.

(vi) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.
Question 9
(a) What are general matters to be considered by an auditor while taking up an engagement?
(b) What are the major sources of obtaining information about the client’s business?

Answer
(a) General matters to be considered while taking up a new engagement:

General Economic factors: General level of economic activity (for example, recession, growth)

(i) The market and competition.
(ii) Cyclical or seasonal activity.
(iii) Government policies.

The industry- important conditions affecting the client’s business

(i) The market and competitions.
(ii) Cyclical or seasonal activity.
(iii) Changes in product technology.
(iv) Business risk.

The entity:

(i) Management and ownership- important characteristics.
(ii) Operating Management.
(iii) The entity’s business – products markets, suppliers, expenses, operations.

(1) Nature of business(es) (for example manufacturing whole seller, financial services, import/ exports).
(2) Location of production facilities, warehouses, offices.
(3) Employment (for example, by location, supply, wage levels, union contracts, pension commitments, Government regulation).
(4) Products or services and markets.

(iv) Financial performance– factors concerning the entity’s financial condition and profitability.

(v) Reporting environment- external influences which affect management in the preparation of the financial statements.

(vi) Legislation:

(1) Regulatory environment and requirements.
(2) Taxation both direct and indirect.
(b) **Information about the client’s business:** The auditor can obtain information about client’s business from the following sources:

(i) The client’s annual Reports to shareholders;
(ii) Minutes of meetings of shareholders, board of directors and important committees;
(iii) Internal financial management report for current and previous periods, including budgets, if any;
(iv) The previous year’s audit working papers, and other relevant files;
(v) Firm personnel responsible for non audit services to the client who may be able to provide information on matters that may affect the audit;
(vi) Discussions with the client;
(vii) The client’s policy and procedures manual;
(viii) Relevant publications of the Institute of Chartered Accountants of India and other professional bodies, industry publication, trade Journals, magazines, newspapers or text books;
(ix) Consideration of the state of the economy and its effects on the client’s business;
(x) Visits to the client’s premises and plant facilities to the management.

**Question 10**

*As an internal auditor of a Cement Manufacturing Company, draft an audit programme for verification of transportation charges for dispatches from the factory.*

**Answer**

**Procedure for Audit of Transportation Charges:**

(i) Check rates contracted with transporters for carriage of goods.
(ii) Check whether the rates mentioned as per the contract are correctly taken in the transporter’s Invoice.
(iii) In case of discrepancy, check whether the same is authorized by the appropriate sanctioning authority.
(iv) Check that the transporter’s invoice includes a delivery challan which has customers stamp indicating the receipt of goods.
(v) In case there is no stamp on the delivery challan, check whether the goods are received back and there is a corresponding inward note.
(vi) Check whether all the goods to be dispatched have a transport booking order reference.
(vii) Check whether each transporter’s invoice mentions the transport booking order reference.
(viii) Check whether all the transport booking orders have corresponding transporters names.
(ix) Check whether the transport booking orders are pre-numbered.
(x) Check whether all the invoices are correctly booked in the books of accounts.
In case there is an additional charge by the transporter due to extra carriage, check for the relevant supporting (like material Inward Note/Customer Rejection Note) and necessary authorization by the sanctioning authority.

Check whether service-tax on the transporters is correctly calculated and accounted.

Verify that there is a mechanism for linking all the Transport Bills to the sale invoices.

**Question 11**

*As an internal auditor for a large manufacturing concern, you are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.*

**Answer**

The Internal Audit Programme in connection with Plant and Machinery and Tools and dies may be on the following lines:

(i) **Internal Control Aspects:** The following may be incorporated in the audit programme to check the internal control aspects-

   (a) Maintaining separate register for hired assets, leased asset and jointly owned assets.

   (b) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.

   (c) All movements of assets are accurately recorded.

   (d) Authorisation be obtained for –

      (1) declaring a fixed asset scrapped.

      (2) selling a fixed asset.

   (e) Check whether additions to fixed asset register are verified and checked by authorised person.

   (f) Proper recording of all additions and disposal.

   (g) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.

   (h) Regular review of adequate security arrangements.

   (i) Periodic inspection of assets is done or not.

   (j) Regular review of insurance cover requirements over fixed assets.

(ii) **Assets Register:** To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.

(iii) **Cost Report and Journal Register:** To review the cost relating to each plant and machinery and to verify items which have been capitalised.
(iv) **Code Register**: To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.

(v) **Physical Verification**: To see physical verification has been conducted at frequent intervals.

(vi) **Movement Register**: To verify (a) whether Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.

(vii) **Assets Disposal Register**: To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.

(viii) **Spare Parts Register**: To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.

(ix) **Review of Maintenance**: To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.

(x) **Review of Obsolescence**: To scrutinise whether expert’s opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.

(xi) **Review of R&D**: To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

**Question 12**

As an auditor of garment manufacturing company for the last five years you have observed that new venture of online shopping has been added by the company during current year. As an auditor what factors would be considered by you in formulating the audit strategy of the company?

**Answer**

**Formulation of Audit Strategy**: While formulating the audit strategy for a company, following factors may be considered -

**General Factors:**

(i) The engagement objectives.

(ii) The results of the business review, including major developments in the client’s business and industry, significant operating results and financial arrangements.

(iii) Preliminary judgements as to materiality.

(iv) Identified inherent risks. The team should also consider the risk of fraud and, in particular, any evidence of a high level of risk to the firm. They should take into account the results of procedures for the acceptance and continuation of clients.

(v) The degree to which the team should carry out further assessment of controls as a means of reducing substantive tests.
(vi) The broad nature, extent and timing of substantive tests, or changes to the previous year’s strategy for substantive testing.

(vii) Main points relating to planning and controlling the audit or comments on the adequacy of the existing arrangements.

Specific Factors for Online Shopping:
The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:

(i) The classes of transactions in the entity’s operations that are significant to the financial statements;

(ii) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

(iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;

(iv) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;

(v) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

Question 13

ME Ltd. is a manufacturing company of Bars and Rods. The turnover of the company for financial year 2015-16 was ₹ 870 crores. The audit committee has appointed MK Associates, Chartered Accountants as an internal auditor of the company for the financial year 2016-17. As an auditor of ME Ltd., draw out the internal audit plan specifying the coverage of area.

Answer

MK Associates, as an internal auditor of ME Ltd., manufacturing company will be covering the below mentioned specified areas while drawing the plan for internal audit:

- Terms of his engagement and any statutory responsibilities.
- Nature and timing of reports or other communication.
- Applicable legal or statutory requirements.
- Accounting policies adopted by the client and changes in those policies.
- Effect of new accounting or auditing pronouncements on the audit.
- Identification of significant audit areas.
- Setting of materiality levels for audit purposes.
Conditions requiring special attention, such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.

Degree of reliance he expects to be able to place on accounting system and internal control.

Nature and extent of audit evidence to be obtained.

Determining the nature, timing and extent of procedures to be performed.

Setting the time budget for each of the activities.

Involvement of experts.

Establishing and coordinating staffing requirements.

How the inventory verification will be witnessed?

Manner of verifying the records of scrap or wastage (normal/abnormal).

Method of physical verification of cash and investment.

How the fixed assets shall be verified?

The internal audit plan should also identify the benchmarks against which the actual results of the activities, the actual time spent, the cost incurred would be measured.