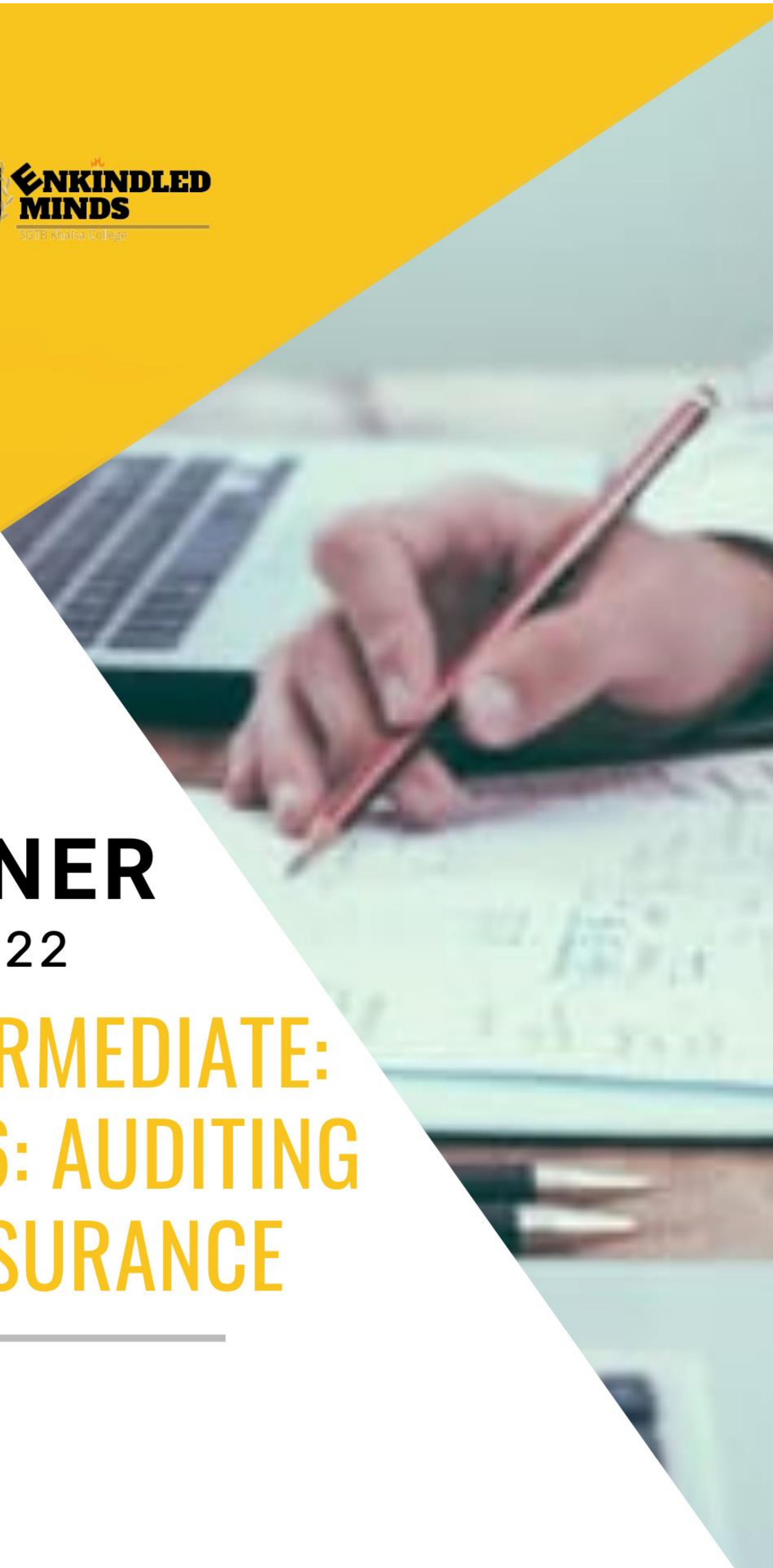
SRI GURU TEGH BAHADUR KHALSA COLLEGE-DELHI-7

EM ENKINDLED MINDS
WE CAN, WE WILL
SGTB Khalsa College



# SCANNER

FOR MAY 22

# CA INTERMEDIATE: PAPER 6: AUDITING AND ASSURANCE

# Chapter 01: Nature, Objective and Scope of Audit

**Q1. State with reason whether the statement is incorrect or not.**

**"There is a very thin difference between advocacy threats and intimidation threats to an auditor while performing his duty".(July 21 Attempt)**

Ans .**Incorrect:** Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised. e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.

Intimidation threats, which occurs when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

So, it can be concluded that there is not very thin difference between the advocacy threats and intimidation threats.

**Q2. The Firm R K & Associates has an extensive understanding of Code of Ethics that underlies the fundamental principles relevant to the Auditor when conducting an Audit of Financial Statements and provides a conceptual framework for applying these principles. Which of the following does not form part of the fundamental principle? (MTP)**

**(a) Integrity**

**(b) Professional Competence and due care**

**(c) Professional Skepticism**

**(d) Professional behavior**

Ans. (c)

**Q3. Examine with reason (in short) whether the following statement is correct or incorrect :**

**The auditor is expected to, and can, reduce audit risk to zero and can therefore obtain absolute assurance. (MTP)**

Ans. **Incorrect:** The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.

**Q4. Discuss the following: (MTP)**

**(a) The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain.**

**(b) Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. Explain stating the qualities an auditor should possess.**

Ans. (a) The person conducting the audit should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

(i) the accounts have been drawn up with reference to entries in the books of account;

(ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;

(iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;

(iv) the information conveyed by the statements is clear and unambiguous;

(v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and

(vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

(b) It is not enough to realise what an auditor should be. He is concerned with the reporting on financial matters of business and other institutions. Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent. The qualities required, according to Dicksee, are tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability. In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor. In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence. In fact, Code of ethics mentions integrity, objectivity and independence as one of the fundamental principles of professional ethics. He must have a thorough knowledge of the general principles of law which govern matters with which he is likely to be in intimate contact. The Companies Act need special mention but mercantile law, specially the law relating to contracts, is no less important. Needless to say, where undertakings are governed by a special statute, its knowledge will be imperative; in addition, a sound knowledge of the law and practice of taxation is unavoidable.

He must pursue an intensive programme of theoretical education in subjects like financial and management accounting, general management, business and corporate laws, computers and information systems, taxation, economics, etc. Both practical training and theoretical education are equally necessary for the development of professional competence of an auditor for undertaking any kind of audit assignment.

The auditor should be equipped not only with a sufficient knowledge of the way in which business generally is conducted but also with an understanding of the special features peculiar to a particular business whose accounts are under audit. The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.

He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques.

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, "an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true".

**Q5. Examine with reason (in short) whether the following statement is correct or incorrect :**

**The preparation of financial statements involves judgment by management.(MTP-2)**

Ans. **Correct:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

**Q6. 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. Explain stating clearly the information that would assist the auditor in accepting and continuing of relationship with the client. (MTP 2)**

Ans. **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.

**Q7. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties. Explain.( RTP Nov21)**

Ans. The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial audi tor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

**Q8. Discuss few guiding principles which are behind safeguards to eliminate threats to auditor's independence. (RTP Nov21)**

Ans. The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

: -

(i) For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.

(ii) In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.

(iii). Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.

(iv) When such threats exist, the auditor should either desist from the task or put in place safeguards that eliminate them.

(v) If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

**Q9. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Discuss the personnel issues addressed by such policies and procedures. Also explain how addressing the personnel issues would empower the firm. (RTP Nov21)**

Ans. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

Such policies and procedures address the following personnel issues:

(a) Recruitment;

(b) Performance evaluation;

(c) Capabilities;

(d) Competence;

(e) Career development;

(f) Promotion;

(g) Compensation; and

(h) Estimation of personnel needs.

Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements. The firm's recruitment processes include procedures that help the firm select individuals of integrity as well as the capacity to develop the capabilities and competence necessary to perform the firm's work.

**Q10. There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. (RTP Nov21)**

**Ans. There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:**

1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.

2. Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that

audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.

3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

**Q11. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The auditor may decide not to send a new audit engagement letter or other written agreement each period. Explain the factors an auditor considers to be appropriate to revise the terms of the audit engagement or to remind the entity of existing terms. (RTP May21)**

Ans. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior maengagemen
- A significant change in ownership.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements.

- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

**Q12. The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats. Explain the guiding principles in this regard.(May21)**

Ans. The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard: -

(i). For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.

(ii). In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.

(iii). Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.

(iv). When such threats exist, the auditor should either desist from the task or put in place safeguards that eliminate them.

(v). If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

**Q13. Discuss preconditions for an audit as per SA 210. Explain how would an auditor**

**proceed to establish the presence of pre conditions for an audit.(RTP may21)**

Ans. As per SA 210 “Agreeing the Terms of Audit Engagements”, preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

In order to establish whether the preconditions for an audit are present, the auditor shall:

(a) Determine whether the financial reporting framework is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework;

(ii) For the internal control as management considers necessary; and

(iii) To provide the auditor with:

➢ Access to all information such as records, documentation and other matters;

➢ Additional information that the auditor may request from management for the purpose of the audit; and

➢ Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

**Q14. Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Explain the matters to be**

**addressed in this context. (RTP May21)**

Ans. The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.

Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
- Processes for complying with applicable engagement standards.
- Processes of engagement supervision, staff training and coaching.
- Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
- Appropriate documentation of the work performed and of the timing and extent of the review.
- Processes to keep all policies and procedures current.

**Q15. Professional skepticism refers to an attitude that includes a questioning mind, being Alert to conditions which may indicate possible misstatement due to error or fraud, And a critical assessment of audit evidence. The auditor shall plan and perform an Audit with professional skepticism recognising that circumstances may exist that Cause the financial statements to be materially misstated. Explain giving examples.(RTP Nov 20)**

Ans.The auditor shall plan and perform an audit with professional skepticism recognising That circumstances may exist that cause the financial statements to be materially Misstated.

Professional skepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence obexample
- Information that brings into question the reliability of documents andResponses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.
- Circumstances that suggest the need for audit procedures in addition to Those required by the SAs.
- Maintaining professional skepticism throughout the audit is necessary if the Auditor is to reduce the risks of:
  - Overlooking unusual circumstances.
  - Over generalizing when drawing conclusions from audit circumstance
  - Using inappropriate assumptions in determining the nature, timing, and extentOf the audit procedures and evaluating the results thereof.

**Q16. Both accounting and auditing are closely related with each other. Explain(RTP Nov 20)**

Ans.Both accounting and auditing are closely related with each other as auditing reviews The financial statements which are nothing but a result of the overall accounting Process. It naturally calls on the part of the auditor to have a thorough and sound Knowledge of generally accepted principles of accounting before he can review the Financial statements. In fact, auditing as a discipline is also closely related with various Other disciplines as there is lot of linkages in the work which is done by an auditor in his Day-to-day activities. To begin with, it may be noted that the discipline of auditing itself

Is a logical construct and everything done in auditing must be bound by the rules of Logic. Ethical precepts are the basis on which the foundation of the entire accounting Profession rests. The knowledge of language is also considered essential in the field Of auditing as the auditor shall be required to communicate, both in writing as well as Orally, in day-to-daywork.

**Q17. As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. Explain clearly stating the meaning of engagement partner and also the actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement.(RTP NOV 20)**

ANS. As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement

Partner shall take responsibility for the overall quality on each audit engagement to Which that partner is assigned.

The actions of the engagement partner and appropriate messages to the other Members of the engagement team, in taking responsibility for the overall quality on Each audit engagement, emphasise:

(a) The importance to audit quality of:

(i) Performing work that complies with professional standards and regulatory And legal requirements;

(ii) Complying with the firm's quality control policies and procedures asApplicable;

(iii) Issuing auditor's reports that are appropriate in the circumstances; and

(iv) The engagement team's ability to raise concerns without fear of reprisals;And

(b) The fact that quality is essential in performing audit engagements.

Engagement partner refers to the partner or other person in the firm who is Responsible for the audit engagement and its performance, and for the auditor's Report that is issued on behalf of the firm, and who, where required, has the Appropriate authority from a professional, legal or regulatory body.

**Q.18The firm should establish policies and procedures designed to provide it with Reasonable assurance that the policies and procedures relating to the system of quality Control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation Of the firm's system of quality control, including a periodic inspection of a selection of Completed engagements.**

**Explain the purpose of monitoring compliance with quality control policies and Procedures(RTP Nov 20)**

ANS.The purpose of monitoring compliance with quality control policies and procedures is To provide an evaluation of:

(a) Adherence to professional standards and regulatory and legal requirements;

(b) Whether the quality control system has been appropriately designed and Effectively implemented; and

Whether the firm's quality control policies and procedures have been appropriately Applied, so that reports that are issued by the firm or engagement partners are Appropriate in the circumstances.

Follow-up by appropriate firm personnel so that necessary modifications are promptly Made to the quality control policies and procedures.

**Q.19 (a) The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing.**

**(b) Explain the objectives of an Audit as per SA 200.(rtp may 20)**

Ans.(a) “An audit is 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.”

Analysis of the Definition

1. Audit is Independent examination of Financial information.
2. Of any entity – that entity may be profit oriented or not and irrespective of its sizeOr legal form. For example – Profit oriented – Audit of Listed company engaged In business. On the other hand, Audit of NGO – not profit oriented.
3. The objective of the audit is to express an opinion on the financial statements.The person conducting this task should take care to ensure that financial statements Would not mislead anybody. This he can do honestly by satisfying himself that:

(i) The accounts have been drawn up with reference to entries in the books of Account;

(ii) The entries in the books of account are adequately supported by sufficient and Appropriate evidence;

(iii) None of the entries in the books of account has been omitted in the process of Compilation and nothing which is not in the books of account has found place in The statements;

(iv) The information conveyed by the statements is clear and unambiguous;

(v) The financial statement amounts are properly classified, described and disclosed In conformity with accounting standards; and

(vi) The statement of accounts present a true and fair picture of the operational Results and of the assets and liabilities.

(B) As per SA-200 “Overall Objectives of the Independent Auditor”, in conducting an audit Of financial statements, the overall objectives of the auditor are:

(a) To obtain reasonable assurance about whether the financial statements as a Whole are free from material misstatement; and

(b) To report on the financial statements, and communicate as required by the SAs,

In accordance with the auditor's findings.

**Q20(a) There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples.**

**(b) In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.(rtp may20)**

Ans.(a) The Nature of Audit Procedures: There are practical and legal limitations on the Auditor's ability to obtain audit evidence. For example

1. There is the possibility that management or others may not provide, intentionally Or unintentionally, the complete information that is relevant to the preparation And presentation of the financial statements or that has been requested by the Auditor.

2. Fraud may involve sophisticated and carefully organised schemes designed to Conceal it. Therefore, audit procedures used to gather audit evidence may be Ineffective for detecting an intentional misstatement that involves, for example, Collusion to falsify documentation which may cause the auditor to believe that Audit evidence is valid when it is not. The auditor is neither trained as nor Expected to be an expert in the authentication of documents.

3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the Auditor is not given specific legal powers, such as the power of search, which May be necessary for such an investigation.

(B) Matters that Affect the Limitations of an Audit: In the case of certain subject Matters, limitations on the auditor's ability to detect material misstatements are Particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a Going concern.

# Chapter 2 - Audit Strategy, Audit Planning and Audit Program

**Q1. You have been appointed as an auditor of a health care service provider. Briefly discuss the special points that should be kept in mind as an auditor for developing an audit programme. (July 21 Attempt)**

Ans. The special points to be kept in mind as an auditor for developing an audit programme of healthcare service provider are:

**1. Register of Patients:** Auditors to vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.

**2. Collection of Cash:** Auditor to check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.

**3. Income from Investments, Rent etc:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.

**4. Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.

**5. Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).

**6. Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.

**7. Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.

**8. Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.

**9. Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.

**10. Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.

**11. Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.

**12. Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.

**13. Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

**Alternative Answer**

**Developing the Audit Programme**

**1. Written Audit Programme:** The auditor should prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.

**2. Audit Objective and Instruction to Assistants:** The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of the work.

**3. Reliance on Internal Controls:** In preparing the audit programme, the auditor, having an understanding of the accounting system and related internal controls, may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. The auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

**4. Timings of Performance of Audit Procedures:** The auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.

**5. Audit Planning:** The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

**Q2. CA R illustrated to his team that the utility of the Audit Programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under recurrent assessment. Which attribute of the Audit**

**Programme is highlighted here?(MTP)**

**(a) Static Review**

**(b) Mechanical Review**

**(c) Periodic Review**

**(d) Obsolete Review**

Ans. (c)

**Q3.“In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement” Explain those considerations in detail. (MTP)**

Ans. In establishing the overall audit strategy, the auditor shall:

(a) Identify the characteristics of the engagement that define its scope;

(b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;

(c) Consider the factors that, in the auditor’s professional judgment, are significant in directing the engagement team’s efforts;

(d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and

(e) Ascertain the nature, timing and extent of resources necessary to perform the engagement .

**Q4. Examine with reason (in short) whether the following statement is correct or incorrect :**

**Evolving one audit programme available to all business under all circumstances is not practicable (MTP 2)**

Ans. **Correct:** Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable

**Q5. In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement. (MTP 2)**

Ans. **In establishing the overall audit strategy**, auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the reporting objectives of the engagement are:

(i) The entity's timetable for reporting, such as at interim and final stages.

(ii) The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work.

(iii) The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.

(iv) The discussion with management regarding the expected communications on the status of audit work throughout the engagement.

**Q6. (MTP 2) Mars Ltd. is a public limited Company incorporated during the previous financial year 2019-20. R S Shah & Associates have been appointed as the Auditors of the Company.**

**Para 1**

**Its Authorized Capital was Rs. 75 Lacs. Subsequently it increased its Share Capital. They issued Shares at a premium of Rs.25/- per share. The Company has transferred**

**the amount received as premium to the Securities Premium Account.**

**Para 2**

**CA R recommended his Engagement Team to prepare an Audit Strategy as well as Audit plan for efficient conduct of audit. He advised to the team that they should include a series of verification procedures to be applied to Financial Statements of the Company for accomplishing the Audit objectives. CA R illustrated to his team the relationship between Audit strategy as well as Audit plan.**

**Para 3**

**Encompassed by a huge clientele, one of the Auditee firm was a LLP. It was in the name of Mangaldeep Geotech LLP. They conducted the business in a very efficient way but had allotted only the Audit and the Income Tax work to CA R S Shah & Associates. The Partners of the LLP were capable enough but however inadvertently bypassed the ROC Compliances. They had no knowledge about the Compliances and its related penalties. Thus they approached CA R S Shah and Associates for their guidance. They were completely clueless as to filing of Annual Return with ROC.**

**Para 4**

**R S Shah and Associates have been appointed as Auditors of a large Enterprise namely Search Results Ltd. Considering the overhaul required in the Organization's Risk Management, Directors of the listed companies braced the subject of Internal Financial Control with much seriousness and rigor. The dawn of the Financial Year lays down the daunting task of establishing and implementing Internal Financial Control in an Enterprise.**

**Para 5**

**The Auditors are performing their Audit work in the Company Search Results Ltd by using CAAT's. The Company is completely automated and all the processes, operations are carried out using the Computer systems. Testing is performed in an**

**automated environment to increase the efficiency and allow for more robust tools to be built. There are four types of testing methods in an Automated environment. They are Inquiry, Observation, Inspection and Re-performance.**

**Q. In reference to para 2, which of the following Statement is inappropriate?**

**(a) Once the overall audit strategy is established, an audit plan can be developed to address the various matters identified in the overall audit strategy.**

**(b) The establishment of overall audit strategy as well as detailed audit plan is a discrete and sequential process.**

**(c) Audit Strategy and Audit plan are inter-related as changes in one may result in consequential changes to the other.**

**(d) The Audit plan is more detailed than the Audit Strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members.**

Ans. (b)

**Q6. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain those factors. (RTP Nov21)**

Ans. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

1. The size and complexity of the entity.

2. The area of the audit.

3. The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).

4. The capabilities and competence of the individual team members performing the

audit work.

**Q7. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways. Explain clearly those ways. (RTP Nov21)**

Ans. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

• Helping the auditor to devote appropriate attention to important areas of the audit.

• Helping the auditor identify and resolve potential problems on a timely basis.

• Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.

• Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.

• Facilitating the direction and supervision of engagement team members and the review of their work.

• Assisting, where applicable, in coordination of work done by auditors of components and experts.

**Q8. What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation.Explain (RTP nov21)**

Ans. Materiality is an important consideration for an auditor to evaluate whether the financial statements reflect a true and fair view or not. SA 320 on “Materiality in Planning and Performing an Audit” requires that an auditor should consider materiality and its relationship with audit risk while conducting an audit. When planning the audit, the auditor considers what would make the financial information materially misstated. The auditor’s preliminary assessment of materiality related to specific account balances and classes of transactions helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk. It may be noted that the auditor’s assessment ofmateriality and audit risk may be different at the time of initially planning of the audit as against at the time of evaluating the results of audit procedures.

At the planning stage, the auditor needs to consider the materiality for the financial statements as a whole. The auditor has to carry out a preliminary identification of significant components and material classes of transactions, account balances and disclosure which he plans to examine. What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation. For example, ` 5,000 may be material for a small entity, but even ` 100,000 may not be material for a large entity.

**Q9. Without adequate knowledge of client's business, a proper audit is not possible. It is one of the important principles in developing an overall audit plan. Explain in context with relevant SA, knowledge to be obtained by the auditor in establishing overall plan. Also explain how such an understanding would be helpful to the auditor. (RTP May21)**

Ans. Without adequate knowledge of client's business, a proper audit is not possible. It is one of the important principles in developing an overall audit plan. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the following:

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

(b) The nature of the entity, including:

(i) its operations;

(ii) its ownership and governance structures;

(iii) the types of investments that the entity is making and plans to make,including investments in special-purpose entities; and

(iv) 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.

(c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.

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

(e) 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 judgements regarding the appropriateness of accounting policies and disclosures.

**Q10. Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes the need to consider certain matters prior to the auditor's identification and assessment of the risks of material misstatement. Explain clearly stating those matters also. (RTP May21)**

Ans. In the context of recurring audits, as per SA-300, "Planning an Audit of Financial Statements", Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor’s identification and assessment of the risks of material misstatement, such matters as:

1. The analytical procedures to be applied as risk assessment procedures.
2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
3. The determination of materiality.
4. The involvement of experts.
5. The performance of other risk assessment procedures.

**Q11. The auditor’s determination of materiality is a matter of professional judgment, and is affected by the auditor’s perception of the financial information needs of users of the financial statements. In this context, explain the auditor’s assumptions about users of the financial statements. (RTP May21)**

Ans. The auditor’s determination of materiality is a matter of professional judgment, and is affected by the auditor’s perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

(i) Have a reasonable knowledge of business and economic activities andaccounting and a willingness to study the information in the financial statements with reasonable diligence;

(ii) Understand that financial statements are prepared, presented and audited to levels of materiality;

(iii) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

(iv) Make reasonable economic decisions on the basis of the information in the financial statements.

**Q12. Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Explain (RTP may21)** Ans. Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

- Misstatements, including omissions, are considered to be material if they,

individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statement

- that about materiality are made in the light of surrounding circumstances,

and are affected by the size or nature of a misstatement, or a combination of both; and

- Judgments about matters that are material to users of the financial statements

are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

**Q13.(a) The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain giving examples.**

**(b) The auditor shall document the overall audit strategy, the audit plan and any significant changes made to the overall audit strategy or the audit plan. Explain in detail giving examples.(RTP NOV 20)**

Ans.The auditor shall plan the nature, timing and extent of direction and supervision of Engagement team members and the review of their work.

The nature, timing and extent of the direction and supervision of engagement team Members and review of their work vary depending on many factors, including:

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement

Example

An increase in the assessed risk of material misstatement for a given area of the Audit ordinarily requires a corresponding increase in the extent and timeliness Of direction and supervision of engagement team members, and a more detailed Review of their work.

4. The capabilities and competence of the individual team members performing the Audit work.

Example

We may have identified a problem related to the production process that raised Concerns about inventory obsolescence. After obtaining an understanding of The entity's process that raised concerns about inventory obsolescence (which We had identified as a significant class of transactions), we concluded that Additional tests of details were required. Therefore, the senior will likely take Part, along with the team, in the discussions with management about the Provision for obsolescence and examine related documentation supporting the Provision, rather than just reading the memo on file. These procedures should Be completed as the work is being performed rather than as an after the fact Review. The extent of the senior's involvement requires judgement, taking into Consideration the complexity of the area and the experience of the team.

(B) auditor shall document:

(a) The overall audit strategy;

(b) The audit plan; andany significant changes made during the audit engagement to the overall audit Strategy or the audit plan, and the reasons for such changes.

The documentation of the overall audit strategy is a record of the key decisions Considered necessary to properly plan the audit and to communicate significant Matters to the engagement team.

Example

The auditor may summarize the overall audit strategy in the form of a memorandum That contains key decisions regarding the overall scope, timing and conduct of the Audit.

The documentation of the audit plan is a record of the planned nature, timing and Extent of risk assessment procedures and further audit procedures at the assertion Level in response to the assessed risks. It also serves as a record of the proper planning Of the audit procedures that can be reviewed and approved prior to their performance.

The auditor may use standard audit programs and/or audit completion checklists, Tailored as needed to reflect the particular engagement circumstances.

A record of the significant changes to the overall audit strategy and the audit plan, And resulting changes to the planned nature, timing and extent of audit procedures, Explains why the significant changes weremade, and the overall strategy and audit plan Finally adopted for the audit. It also reflects the appropriate response to the significant Changes occurring during the audit.

Example

The following things should form part of auditor's documentation:

- A summary of discussions with the entity's key decidocumentatio

- Documentation of audit committee pre-approval of services, where required.
- Audit documentation access letters.
- Other communications or agreements with management or those charged with Governance regarding the scope, or changes in scope, of our services.
- Auditor's report on the entity's financial stateserviceOther reports as specified in the engagement agreement (e.g., debt covenant Compliance letter).

**Q14. (a) Evolving one audit programme applicable to all business under all circumstances is not practicable. Explain clearly stating in detail the meaning of audit programme.**

**(b) most of the assertions much of the evidence be drawn and each one should be Considered and weighed to ascertain its weight to prove or disprove the assertion. An Auditor picks up evidence from a variety of fields.Analyse and explain with the help of Examples.( RTP NOV 20)**

Ans. (a) Businesses vary in nature, size and composition; work which is suitable to one business May not be suitable to others; efficiency and operation of internal controls and the Exact nature of the service to be rendered by the auditor are the other factors that Vary from assignment to assignment. On account of such variations, evolving one Audit programme applicable to all business under all circumstances is not practicable. However, it becomes a necessity to specify in detail in the audit programme the nature Of work to be done so that no time will be wasted on matters not pertinent to the Engagement and any special matter or any specific situation can be taken care of.

It is desirable that in respect of each audit and more particularly for bigger audits an Audit programme should be drawn up. Audit programme is a list of examination and Verification steps to be applied and set out in such a way that the inter-relationship of One step to another is clearly shown and designed, keeping in view the assertions

Discernible in the statements of account produced for audit or on the basis of an

Appraisal of the accounting records of the client.

Definition : An audit programme consists of a series of verification procedures to be

Applied to the financial statements and accounts of a given company for the purpose of

Obtaining sufficient evidence to enable the auditor to express an informed opinion on

Such statements.

In other words, an audit programme is a detailed plan of applying the audit procedures

In the given circumstances with instructions for the appropriate techniques to be

Adopted for accomplishing the audit objectives.

**(c)** In most of the assertions much of the evidence be drawn and each one should be

Considered and weighed to ascertain its weight to prove or disprove the assertion. In

This process, an auditor would be in a position to identify the evidence that brings the

Highest satisfaction to him about the appropriateness or otherwise of the assertion.

An auditor picks up evidence from a variety of fields and it is generally of the following

Broad types:

(a) Documentary examination,

(b) Physical examination,

Statements and explanation of management, officials andemployees,

(c) Statements and explanations of third parties,

(d)Arithmetical calculations by the auditor,

(f) State of internal controls and internal checks,

(g) Inter-relationship of the various accounting data,

(h) Subsidiary and memorandum records,

(i) Minutes,

(j) Subsequent action by the client and by others.

Example

1. For cash in hand, the best evidence is 'count'
2. For investment pledged with a bank, the banker's certificate.
3. For verifying assertions about book debts, the client's ledger invoices, debit Notes, credit notes, monthly accounts statement sent to the customers are

All evidence: some of these are corroborative, other being complementary.

In addition, balance confirmation procedure is often resorted to, to obtain Greater satisfaction about the reliability of the assertion.

The auditor, however, has to place appropriate weight on each piece of evidence And accordingly should prescribe the priority of verification. It is true that in al l Cases one procedure may not bring the highest satisfaction and it may be Dangerous for the auditor to ignore any evidence that is available. By the word "available" we do not mean that the evidence available with the client is the only Available evidence. The auditor should know what normally should be available in The context of the transaction having regard to the circumstances and usage.

**Q15. (a) Plans should be further developed and revised as necessary during the course of the audit. Explain.**

**(b) Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The process of establishing the overall audit strategy assists the auditor to determine such matters as for example – the resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters. Explain the other three such matters.(RTP MAY 20)**

Ans.(a) Plans should be further developed and revised as necessary during the course

Of the audit.

SA-300, "Planning an Audit of Financial Statements" further expounds this principle. According to it, planning is not a discrete phase of an audit, but rather a continual And iterative process that often begins shortly after (or in connection with) the Completion of the previous audit and continues until the completion of the current Audit engagement. The auditor shall establish an overall audit strategy that sets the Scope, timing and direction of the audit, and that guides the development of the audit Plan.

(b) audit strategy sets the scope, timing and direction of the audit, and guides The development of the more detailed audit plan.

The auditor shall establish an overall audit strategy that sets the scope, timing and Direction of the audit, and that guides the development of the audit plan.

The process of establishing the overall audit strategy assists the auditor to Determine, subject to the completion of the auditor's risk assessment procedures, Such matters as:

1. The resources to deploy for specific audit areas, such as the use of appropriately Experienced team members for high risk areas or the involvement of experts on Complex matters;
2. The amount of resources to allocate to specific audit areas, such as the number Of team members assigned to observe the inventory count at material locations, The extent of review of other auditors' work in the case of group audits, or the Audit budget in hours to allocate to high risk areas;
3. When these resources are to be deployed, such as whether at an interim audit Stage or at key cut-off dates; and
4. How such resources are managed, directed and supervised, such as when team

Briefing and debriefing meetings are expected to be held, how engagement

Partner and manager reviews are expected to take place (for example, on-site

Or off-site), and whether to complete engagement quality control reviews.

**Q16. (a) Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiatewith the help of examples.**

**(b) Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques.**

**Analyse and explain with the help of example of evidence in respect of Sales.(RTP MAY 20)**

Ans. (a) Examples are :

- The competitive environment, including demand, capacity, product and priceCompetition as well as cyclical or seasonal activity.
- Supplier and customer relationships, such as types of suppliers and customers (e.g., related parties, unified buying groups) and the related contracts with those Entities.
- Technological developments, such as those related to the entity's products, Energy supply and cost.
- The effect of regulation on entity operations.

(B) Evidence is the very basis for formulation of opinion and an audit programme is

Designed to provide for that by prescribing procedures and techniques. What is best

Evidence for testing the accuracy of any assertion is a matter of expert knowledge And experience. This is the primary task before the auditor when he draws up the Audit programme. Transactions are varied in nature and impact; procedures to be Prescribed depend on prior knowledge of what evidence is reasonably available in Respect of each transaction.

Example

Sales are evidenced by:

(i) Invoices raised by the client;

(ii) Price list;

(iii) Forwarding notes to client;

(iv) Inventory-issue records;

(v) Sales managers' advice to the inventory section;

(vi) Acknowledgements of the receipt of goods by the customers; and

(vii) Collection of money against sales by the client.

## Chapter 03 : Audit Documentation & Audit Evidence

**Q1. Documentation of audit plan serves as a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. What all activities in the planning phase should form part of auditor's documentation? State with examples. (July 21 Attempt)**

Ans. The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

**Example**

The following things should form part of auditor's documentation:

- A summary of discussions with the entity's key decision makers
- Documentation of audit committee pre-approval of services, where required.
- Audit documentation access letters.
- Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services.
- Auditor's report on the entity's financial statements.
- Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter).

**Q2. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. With reference to SA 560, what are the audit procedures included in the auditor's risk assessment? (July 21 Attempt)**

Ans. **The auditor shall perform audit procedures designed to obtain sufficient**

**appropriate audit evidence** that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements have been identified.

The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor’s report, or as near as practicable thereto. The auditor shall take into account the auditor’s risk assessment which shall include the following:

(a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

(b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.

(c) Reading minutes, if any, of the meetings, of the entity’s owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

(d) Reading the entity’s latest subsequent interim financial statements, if any.

**Q3. CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level. (July 21 Attempt)**

Ans. Negative confirmations is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative information provide less persuasive audit evidence than positive confirmations. Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

(a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;

(b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;

(c) A very low exception rate is expected; and

(d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

**Q4. (MTP) RM & Associates have been appointed as Auditors of Techblocks Consulting Ltd. for the year 2020-21. CA R and CA M were the Engagement partners.**

**Para 1**

**The Firm has freshly appointed 2 Article Clerks who had no practical knowledge in the area of Auditing. They had to work to tight hard-headed factual issues and were baffling to understand the various terms and their objectives in the field of Auditing.**

**Para 2**

**To make sure that the Article Clerk do not misplace or mis-handle the Working Papers, CA M also described the relevance of Audit File and clarified that working papers are the property of Auditor. Such Audit file should be preserved for a period of seven years.**

**Para 3**

**CA R while scrutinizing Books of Accounts suspected some fictitious sales as a result of**

**which he anticipated inflated Debtors. Management was reluctant to give the details. As CA R could not gather more evidence from the Management, he sought to obtain details from the third party.**

**Para 4**

**On further perusal of Opening Balances, it is essential to perceive that Accounting Policies have been consistently applied in the current period's financial statements and whether any changes have been properly accounted for and disclosed. CA M assigned this duty to his article clerk. The Article clerk explained to CA M about how he had observed that Accounting policies were not consistently applied in relation to opening balances in accordance with the financial reporting framework or a change is not properly accounted or not adequately disclosed.**

**Para 5**

**Subsequently, the Auditors gathered from the Management that there was a fire in the Factory premises after the Balance Sheet date, as a result of which the company suffered loss of Inventories. It did not provide any conditions on the Balance Sheet date. SA 560 deals with such type of transactions.**

**1. The Auditor explained his Audit team the purpose of Audit Documentation. Which of the following is incorrect with respect to the purpose of Audit Documentation?**

**(a) It enables the conduct of quality control reviews and inspections in accordance with SQC-1.**

**(b) It helps in preparation of Financial Statements.**

**(c) It retains a record of matters of continuing significance to future audits.**

**(d) It enables the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.**

Ans. (b)

**2. An auditor strictly ensured that the audit team should document / assemble all the**

**working papers in Audit file. The completion of assembling the Audit File is an administrative process and should be done in :**

**(a) It should be within 30 days from the date of Audit Report**

**(b) It should be within 60 days from the completion of Audit.**

**(c) It should not be more than 60 days from the date of Audit Report.**

**(d) It should be before 90 days from the completion of Audit.**

Ans. (c)

**3. With reference to para 3 of Case scenario, this is a case of obtaining External Confirmation by the Auditor. Which of the following is inappropriate with regard to External Confirmation?**

**(a) External Confirmations are restricted to Account balances only.**

**(b) It is also used in a case to obtain Audit evidence about the absence of certain conditions say, Side Agreement.**

**(c) It can be also effective in obtaining Audit evidence about verification of Inventories held by third parties at bonded warehouses for processing or on consignment.**

**(d) External Confirmation is also functional in case of Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the Balance Sheet date.**

Ans (a)

**4. With reference to para 4, in such a situation CA M shall express a :**

**(a) A Disclaimer Opinion**

**(b) A qualified opinion**

**(c) A qualified opinion or an adverse opinion in accordance with SA 705**

**(d) An unmodified opinion**

Ans. (c)

**5. In respect to subject matter mentioned in Para 5, what procedures should Auditor**

**perform to identify such events?**

**Statement 1: Obtain an understanding of any procedures management has established as well as Inquiry with Management and those charged with governance procedures for identification of such subsequent events.**

**Statement 2: Inspection of Minutes of the meetings of the entity's owners, management and those charged with governance that have been held after the date of the financial statements and inquiring about the matters discussed at any such meetings for which minutes are not yet available.**

**Statement 3: The Auditor should not read the entity's latest subsequent interim financial statements, if any.**

**(a) Only Statement 1 is correct**

**(b) Only Statement 2 is correct**

**(c) Both Statements 1 and 2 are correct**

**(d) Only Statement 3 is correct**

Ans. (c)

**Q5. Which of the following is not an example of an event or condition that may cast significant doubt on entity's ability to continue as a going concern: (MTP)**

**(a) Loss of key management without replacement**

**(b) Adverse key financial ratios**

**(c) Inability to pay creditors on due date**

**(d) Current year profit turns to loss after charging depreciation**

Ans. (d)

**Q6. Examine with reason (in short) whether the following statement is correct or incorrect :**

**Audit evidence obtained from external confirmation is always reliable. (MTP)**

Ans. **Incorrect:** The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

**Q7. Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered. Further, it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Explain giving examples. (MTP)**

Ans. Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

 The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.

 The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.

 An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.

 In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:

- For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor’s exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management’s responses to the auditor’s inquiries.

• Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner’s timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315.

**Q8. While conducting audit of Vee Ltd., CA Aman, auditor of the company found that some goods are lying with third party for a long period. Advise Aman how will he verify them. (MTP)**

Ans. **Goods Lying with Third Party:** The auditor should check that the materiality of the item under this caption included in inventories.

(i) He should obtain confirmation of the amount of goods lying with them. The confirmation may be directly obtained by auditor or be produced by client depending upon the situation.

(ii) He should inquire into the necessity of sub contractor retaining the inventory. He should ensure the process that they do are related to the business requirement and there is no ground for suspicion on this score.

(iii) The goods lying with them for the very long period would merit auditors’ special attention for making provision.

(iv) The records, voucher/slips for the regulating the movement of inventory into and out of entity for sub-contracting work be reviewed by vouching for few transaction for ensuring existence and working of internal control system for them.

(v) The excise gate pass, entry in such records, information in returns, be also cross - verified.

(vi) The valuation of inventories should be correctly made for including material cost on appropriate inventory valuation formulae and also for inclusion of proportionate processing charges for the work in process with the contractors.

(vii) The provision should be created for work done, billed for processing and also for incidence of any applicable levy like service tax payable.

(viii) Evaluate condition of goods and see whether adequate provision has been made.

(ix) Check whether subsequently the goods lying with third party were sold or received back after the expiry of stipulated time period.

(x) Ensure that the goods have been included in the closing inventory though lying with third party.

**Q9. Examine with reason (in short) whether the following statement is correct or incorrect :**

**Inquiry alone ordinarily does not provide sufficient audit evidence. (MTP 2)**

Ans**. Correct:** Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

**Q10. Explain the objectives of the auditor regarding written representations. (MTP 2)**

Ans. **The objectives of the auditor regarding written representation:**

(**i) To obtain written representations**

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

**(ii) To support other evidence**

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

**(iii) To respond appropriately**

To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

**Q11. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation. (MTP 2)**

Ans. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

(a) Discuss the matter with management and, where appropriate, those charged with governance.

(b) Determine whether the financial statements need amendment and If so,

(c) Inquire how management intends to address the matter in the financial statements.

**Q12. Audit documentation provides: (MTP 2)**

**(a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; or evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.**

**(b) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and evidence that the audit was planned and performed in**

**accordance with SAs and applicable legal and regulatory requirements.**

**(c) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor**

**(d) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.**

Ans. (b)

**Q13. Audit evidence includes (MTP 2)**

**(a) information contained in the accounting records underlying the financial statements**

**(b) both information contained in the accounting records underlying the financial statements and other information.**

**(c) other information.**

**(d) information contained in the accounting records underlying the financial statements information.**

Ans. (b)

**Q14. (MTP 2) Mars Ltd. is a public limited Company incorporated during the previous financial year 2019-20. R S Shah & Associates have been appointed as the Auditors of the Company.**

**Para 1**

**Its Authorized Capital was Rs. 75 Lacs. Subsequently it increased its Share Capital. They issued Shares at a premium of Rs.25/- per share. The Company has transferred the amount received as premium to the Securities Premium Account.**

**Para 2**

**CA R recommended his Engagement Team to prepare an Audit Strategy as well as Audit plan for efficient conduct of audit. He advised to the team that they should include a series of verification procedures to be applied to Financial Statements of the**

**Company for accomplishing the Audit objectives. CA R illustrated to his team the relationship between Audit strategy as well as Audit plan.**

**Para 3**

**Encompassed by a huge clientele, one of the Auditee firm was a LLP. It was in the name of Mangaldeep Geotech LLP. They conducted the business in a very efficient way but had allotted only the Audit and the Income Tax work to CA R S Shah & Associates. The Partners of the LLP were capable enough but however inadvertently bypassed the ROC Compliances. They had no knowledge about the Compliances and its related penalties. Thus they approached CA R S Shah and Associates for their guidance. They were completely clueless as to filing of Annual Return with ROC.**

**Para 4**

**R S Shah and Associates have been appointed as Auditors of a large Enterprise namely Search Results Ltd. Considering the overhaul required in the Organization's Risk Management, Directors of the listed companies braced the subject of Internal Financial Control with much seriousness and rigor. The dawn of the Financial Year lays down the daunting task of establishing and implementing Internal Financial Control in an Enterprise.**

**Para 5**

**The Auditors are performing their Audit work in the Company Search Results Ltd by using CAAT's. The Company is completely automated and all the processes, operations are carried out using the Computer systems. Testing is performed in an automated environment to increase the efficiency and allow for more robust tools to be built. There are four types of testing methods in an Automated environment. They are Inquiry, Observation, Inspection and Re-performance.**

**Q. Which of the following statement is inappropriate with regard to testing methods as mentioned in Para 5 above?**

**(a) Inquiry in combination with Inspection gives the most effective and efficient audit evidence.**

**(b) Re-performance is the most effective as an audit test and gives the best audit evidence.**

**(c) Inquiry should always be used in combination with any other testing method.**

**(d) which audit test to use and in what combination does not require professional judgment.**

Ans. (d)

**Q.15 (a) An important factorin determining theform, content and extent ofaudit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Explain stating clearly the examples of significant matters.**

**(b) Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement and also by the quality of such audit evidence. Obtaining more audit evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgment as to sufficiency of audit evidence.(RTP NOV 20)**

ANS.(a) Judging the significance of a matter requires an objective analysis of the facts and Circumstances.

Examples of significant matters include:

 Matters that give rise to significant risks.

 Results of audit procedures indicating (a) that the financial statements could be Materially misstated, or (b) a need to revise the auditor's previous assessment Of the risks of material misstatement and the auditor's responses to those risks.

 Circumstances that cause the auditor significant difficulty in applying necessary Audit procedures.

 Findings that could result in a modification to the audit opinion or the inclusion

Of an Emphasis of Matter Paragraph in the auditor’s report.

An important factorin determining theform, content and extent ofaudit documentation of Significant matters is the extent of professional judgement exercised in performing the Work and evaluating the results. Documentation of the professional judgements Made, where significant, serves to explain the auditor’s conclusions and to reinforce

The quality of the judgement. Suchmatters are of particular interest to those responsible For reviewing audit documentation, including those carrying out subsequent audits, When reviewing matters of continuing significance (for example, when performing a Retrospective review of accounting estimates).

**(c)** Sufficiency is the measure of the quantity of audit evidence. The quantity of audit

Evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and Also by the quality of such audit evidence (the higher the quality, the less may be Required). Obtaining more audit evidence, however, may not compensate for its poor Quality. Auditor's judgement as to sufficiency may be affected by the factors Such as:

(i) Materiality

(ii) Risk of materialmisstatement

(iii) Size and characteristics of the population.

(a) Materiality may be defined as the significance of classes of transactions,Account balances and presentation and disclosures to the users of theFinancial statements. Less evidence would be required in case assertions Are less material to users of the financial statements. But on the other handIfassertions are more material to the users of the financial statements, more Evidence would be required.

(2) Risk of material misstatement may be defined as the risk that the Financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level (a) Inherent risk—The susceptibility of an assertion to a misstatement that could be

material before consideration of any related controls. (b) Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control. Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand if assertions have a higher risk of material misstatement, more evidence would be required.

(c) Size of a population refers to the number of items included in the population. Less evidence would be required in case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

**Q16. Give examples of financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. (RTP Nov21)**

Ans. The following are examples of Financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern :

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term aconcer
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.

**Q17. SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to**

**subsequent events in an audit of financial statements. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Explain those events and also define subsequent events (RTP nov21)**

Ans. SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.

Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

(a) Those that provide evidence of conditions that existed at the date of the financial statements; and

(b) Those that provide evidence of conditions that arose after the date of the financial statements.

SA 700 explains that the date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.

Subsequent events refer to events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

**Q18. The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances. During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that**

**may provide information about related party relationships and transactions. Explain indetailwith examples. (RTP Nov21)**

Ans. During the audit, the auditor should maintain alertness for related party information while

reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.

2. Information supplied by the entity to regulatory authorities.

3. Shareholder registers to identify the entity's principal shareholders.

4. Statements of conflicts of interest from management and those charged with governance.

5. Records of the entity's investments and those of its pension plans.

6. Contracts and agreements with key management or those charged with governance.

7. Significant contracts and agreements not in the entity's ordinary course of business.

8. Specific invoices and correspondence from the entity's professional advisors.

9. Life insurance policies acquired by the entity.

10. Significant contracts re-negotiated by the entity during the period.

11. Internal auditors' reports.

12. Documents associated with the entity's filings with a securities regulator e.g, prospectuses)

**Q19. A new team member of GSR & Co., the auditors of Esteem Limited, was of the view that Audit Documentation would not serve any purpose at any stage of Audit. Explain. (RTP May21)**

Ans. The following are the purpose of Audit documentation:

1. Assisting the engagement team to plan and perform the audit.

2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.

3. Enabling the engagement team to be accountable for its work.

4. Retaining a record of matters of continuing significance to future audits.

5. Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.

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

From the above, it can be concluded that Audit documentation serves a number of purposes and hence it would be incorrect to say that audit documentation would not serve any purpose at any stage of audit.

**Q20. While documenting the nature, timing and extent of audit procedures performed in case of audit of PQR Ltd, explain the important matters its auditor shouldrecord.(RTP May21)**

Ans. In documenting the nature, timing and extent of audit procedures performed, the auditor of PQR Ltd shall record:

(i) The identifying characteristics of the specific items or matters tested.

(ii) Who performed the audit work and the date such work was completed; and

(iii) Who reviewed the audit work performed and the date and extent of such review.

**Q21. When information to be used as audit evidence has been prepared using the work of a management's expert and having regard to the significance of expert's work for the auditor's purposes, explain the considerations auditor would consider for the purposes of his audit. (RTP MAY21)**

Ans. When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

(i) Evaluate the competence, capabilities and objectivity of that expert;

(ii) Obtain an understanding of the work of that expert; and

(iii) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

**Q22. When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor has determined that management of XYZ Ltd has already performed a preliminary assessment of the entity's ability to continue as a going concern. Explain how would auditor of XYZ Ltd proceed in the above case.**

**Also explain how would the auditor proceed if such an assessment has not yet been performed by the management. (RTP May21)**

Ans. When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern.

In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

(i) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or

(ii) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

**Q23. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations**

**for the foreseeable future. Explain. Also discuss the objectives of an auditor regarding Going concern as per relevant standard on auditing. (RTP May21)**

Ans.Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future.

General purpose financial statements are prepared using the going concern basis of accounting, unless management either

(i) intends to liquidate the entity or to cease operations,

(ii) or has no realistic alternative but to do so.

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

The objectives of the auditor regarding Going Concern are:

(1) To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

(2) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(3) To report in accordance with this SA.

**Q24. as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. Explain stating the auditor's responsibilities with regard to going concern. (RTP May21)**

Ans. The auditor's responsibilities are:

(1) to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and

(2) to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

**Q.25(a)Therearespecificaccountinganddisclosurerequirementsforrelatedpartyrelationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.**

**Explain in detail stating clearly the auditor's responsibility in the above context.**

**(b) The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. Explain with the help of examples.(RTP NOV 20)**

Ans.(a) Therearespecificaccountinganddisclosurerequirementsforrelatedpartyrelationships, Transactions and balances to enable users of the financial statements to understand Their nature and effects on the financial statements.

The auditor has a responsibility to perform audit procedures to identify, assess and Respond to the risks of material misstatement arising from the entity's failure to Appropriately account for related party relationships, transactions or balances.

The auditor needs to obtain an understanding of the entity's related party relationships And transactions sufficient to be able to conclude whether the financial statements, Insofar as they are affected by those relationships and transactions:

(a) Achieve a true and fair presentation ; or

(b) Are not misleading (for compliance frameworks).

In addition, an understanding of the entity's related party relationships and transactions Is relevant to the auditor's evaluation of whether fraud risk factors are present as Required by SA 240. This is because fraud may be more easily committed through Related parties.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some Material misstatements of the financial statements may not be detected, even though The audit is properly planned and performed in accordance with the SAs. In the context Of related parties, the potential effects of inherent limitations on the auditor's ability to Detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party Relationships.
- Related party relationships may present a greater opportunity for collusion, Concealment or manipulation by management.

Planning and performing the audit with professional skepticism as required by SA200 is therefore particularly important in this context, given the potential for undis closed related party relationships and transactions. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

(b) The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.

Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist. Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

**Q. 26(a) A higher level of assurancemay be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls. Explain and also state when will the auditor design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls.**

**(b) When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Discuss the matters the auditor may consider in determining the extent of test of controls.(RTP NOV 20)**

**Ans.** (a) Test of controls may be defined as an audit procedure designed to evaluate the

Operating effectiveness of controls in preventing, or detecting and correcting, material Misstatements at the assertion level.

The auditor shall design and perform tests of controls to obtain sufficient appropriate Audit evidence as to the operating effectiveness of relevant controls when:

(a) The auditor's assessment of risks of material misstatement at the assertion Level includes an expectation that the controls are operating effectively (i.e., the Auditor intends to rely on the operating effectiveness of controls in determining The nature, timing and extent of substantive procedures); or

(b) Substantive procedures alone cannot provide sufficient appropriate audit Evidence at the assertion level.

A higher level of assurancemay be sought about the operating effectiveness of controls When the approach adopted consists primarily of tests of controls, in particular where it Is not possible or practicable to obtain sufficient appropriate audit evidence only from Substantive procedures.

(c) When more persuasive audit evidence is needed regarding the effectiveness of a Control, it may be appropriate to increase the extent of testing of the control as well As the degree of reliance on controls. Matters the auditor may consider in determining The extent of test of controls include the following:

1. The frequency of the performance of the control by the entity during the period.The length of time during the audit period that the auditor is relying

operating effectiveness of the control.

3. The expected rate of deviation from a control.

4. The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.

5. The extent to which audit evidence is obtained from tests of other controls related

to the assertion.

**Q27. (a) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation.**

**(b) The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a f act becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation**.(RTP MAY 20)

ANS. (a) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

Written representations are requested from those responsible for the preparation and presentation of the financial statements.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

The objectives of the auditor regarding written representation

The objectives of the auditor are:

(a) To obtain written representations

To obtain written representations from management. Also that management Believes that it has fulfilled its responsibility for the preparation of the financial Statements and for the completeness of the information provided to the auditor;

(b) To support other evidence

To support other audit evidence relevant to the financial statements or specific Assertions in the financial statements by means of written representations; and

To respond appropriately

To respond appropriately to written representations provided by management or If management does not provide the written representations requested by the Auditor.

(c) The auditor has no obligation to perform any audit procedures regarding the financial Statements after the date of the auditor's report. However, when, after the date of the Auditor's report but before the date the financial statements are issued, a fact Becomes known to the auditor that, had it been known to the auditor at the date of The auditor's report, may have caused the auditor to amend the auditor's report, the Auditor shall:

(a) Discuss the matter with management and, where appropriate, those charged With governance.

(b) Determine whether the financial statements need amendment and, if so, Inquire how management intends to address the matter in the financial

Statements.

**Q28. (a) The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples.**

**(b) When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests.(RTP May 20)**

Ans.(a) Many related party transactions are in the normal course of business. In such Circumstances, they may carry no higher risk of material misstatement of the financial Statements than similar transactions with unrelated parties. However, the nature of Related party relationships and transactions may, in some circumstances, give rise to Higher risks of material misstatement of the financial statements than transactions With unrelated parties.

Example

 Related parties may operate through an extensive and complex range of Relationships and structures, with a corresponding increase in the complexity of Related party transactions.

 Information systems may be ineffective at identifying or summarising Transactions and outstanding balances between an entity and its related parties.

 Related party transactions may not be conducted under normal market terms And conditions; for example, some related party transactions may be conducted

With no exchange of consideration.

**(c)** When using external confirmation procedures, the auditor shall maintain control over External confirmation requests, including:

(a) Determining the information to be confirmed or requested;

(b) Selecting the appropriate confirming party;

Designing the confirmation requests, including determining that requests are Properly addressed and contain return information for responses to be sent Directly to the auditor; and

(c) Sending the requests, including follow-up requests when applicable, to the Confirming party.

**Q29 (a) Define the following :**

**(i) Positive confirmation request**

**(ii) Negative confirmation request**

**(iii) Non-response**

**(iv) Exception**

**(B) Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.(Rtp may 20)**

Ans.(a) Positive confirmation request – A request that the confirming party respond directly To the auditor indicating whether the confirming party agrees or disagrees with theInformation in the request, or providing the requested information.

Negative confirmation request – A request that the confirming party respond Directly to the auditor only if the confirming party disagrees with the information Provided in the request.

Non-response – A failure of the confirming party to respond, or fully respond, to a Positive confirmation request, or a confirmation request returned undelivered.

Exception – A response that indicates a difference between information requested

To be confirmed, or contained in the entity's records, and information provided by the

Confirming party.

(B) Matters relevant in planning attendance at physical inventory counting include,

For example:

(a) Nature of inventory.

(b) Stages of completion of work in progress.

The risks of material misstatement related to inventory.

(c) The nature of the internal control related to inventory.

€ Whether adequate procedures are expected to be established and proper

Instructions issued for physical inventory counting.

(f) The timing of physical inventory counting.

(g) Whether the entity maintains a perpetual inventory system.

(h) The locations at which inventory is held, including the materiality of the inventory

And the risks of material misstatement at different locations, in deciding at which

Locations attendance is appropriate

(i) Whether the assistance of an auditor's expert is needed.

# Chapter04: Risk Assessment and Internal Control

**Q1. State with reason whether the statement is correct or incorrect.**

**"In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater". (July 21 Attempt)**

Ans. **Correct:** In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party relationships.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.

**Q2. In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters. (July 21 Attempt)**

Ans. In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern

**Q3. CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which include observation and inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations. (July 21 Attempt)**

Ans. Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

Examples of audit procedures which include observation or inspection of the entity's operations are:

(1) Documents (such as business plans and strategies), records, and internal control manuals.

(2) Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of director's meetings)

(3) The entity's premises and plant facilities.

**Q4. A Partnership Firm of Chartered Accountants by the name of HS and Associates was appointed to audit books of accounts of WT Limited for financial year 2019-20. HS and Associates consisted of two partners CA H and CA S.**

**While conducting audit of WT Limited for financial year 2019-20, CA H, one of the partners of HS and Associates used different audit procedures in order to obtain audit evidence. The different audit procedures used by CA H were as follows:**

**(1) As WT Limited was engaged in manufacturing business of wooden doors, CA H and his team members carefully watched the whole process of counting of finished wooden doors by employees of WT Limited. The counting of finished wooden doors was necessary for the purpose of verification of stock of finished wooden doors.**

**(2) In WT Limited the stock of finished wooden doors was valued manually by multiplying number of finished wooden doors with value per finished wooden door. A team member of CA H again did the calculation in order to verify the accuracy regarding valuation of stock of wooden finished doors.**

**(3) CA H with the help of his team members obtained information from people (who were experienced in manufacturing business of wooden doors) about the purchase price of raw materials required in manufacturing business of wooden doors and also**

**obtained some non-financial information.**

**(4) CA H and his team members while conducting the audit of WT Limited for financial year 2019-20 in detail checked and evaluated the books of accounts and relevant documents of W Limited.**

**(5) CA H asked for written confirmations regarding account balances from Debtors and Creditors of WT Limited.**

**Keeping the basic concepts about various audit procedures in mind, answer the following multiple –choice questions: (MTP)**

**1. CA H and his team members carefully watched the whole process of counting of finished wooden doors by employees of WT Limited. This is an example of which audit procedure:**

**(a) External Confirmation.**

**(b) Observation.**

**(c) Inquiry.**

**(d) Inspection.**

Ans. Observation

**2. In order to verify the accuracy regarding valuation of stock of wooden finished doors, a team member of CA H again did the calculation. This is an example of which audit procedure:**

**(a) Analytical Procedures.**

**(b) Inquiry.**

**(c) Inspection.**

**(d) Recalculation.**

Ans. Recalculation.

**3. CA H with the help of his team members obtained information (both financial and non-financial information) from experienced people in manufacturing business of**

**wooden doors. These experienced people provided the required information. This whole method of obtaining information is an example of which audit procedure:**

**(a) Inspection**

**(b) Reperformance.**

**(c) Inquiry.**

**(d) Investigation.**

Ans. Inquiry

**4. CA H and his team members in detail checked and evaluated the books of accounts and relevant documents of WT Limited. This is an example of which audit procedure:**

**(a) Inspection.**

**(b) Reperformance.**

**(c) Recalculation.**

**(d) Investigation**

Ans. Inspection

**5. Asking for written confirmations regarding account balances from Debtors and Creditors of WT Limited**

**by CA H is an example of which audit procedure:**

**(a) Inquiry**

**(b)Inspection**

**(c)Investigation.**

**(d) External Confirmation.**

Ans. External Confirmation

**Q5. Examine with reason (in short) whether the following statement is correct or incorrect :**

**The concept of materiality is an important and relevant consideration for the auditor in financial statement. (MTP)**

Ans. **Correct:** The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not and ensure that a material item is disclosed separately and distinctly.

**Q6. The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control. (MTP)**

Ans. **Division of Internal Control into Components:** The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:

(i) The control environment;

(ii) The entity's risk assessment process;

(iii) Monitoring of controls.

(iv) Control activities; and

(v) The information system, including the related business processes, relevant to financial reporting, and communication;

**Q7. Examine with reason (in short) whether the following statement is correct or incorrect :**

**The SAs do not ordinarily refer to inherent risk and control risk separately. (MTP 2)**

Ans. **Correct:** The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non- quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

**Q8. Explain the meaning of internal financial controls as per the Companies Act, 2013. Also, state its objectives. (MTP 2)**

Ans. **Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls as,** "the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information."

From the above definition, it is clear that internal financial controls are the policies and procedures adopted by the company for:

1. ensuring the orderly and efficient conduct of its business, including adherence to company's policies,
2. the safeguarding of its assets,
3. the prevention and detection of frauds and errors,
4. the accuracy and completeness of the accounting records, and
5. the timely preparation of reliable financial information."

**Q9. Risk of material misstatement may be defined as the risk (MTP 2)**

**(a) that the financial statements are materially misstated after audit.**

**(b) that the financial statements are materially misstated during audit.**

**(c) that the financial statements are materially misstated prior to audit.**

**(d) All of the above**

Ans. (c)

**Q10. (MTP 2) Mars Ltd. is a public limited Company incorporated during the previous financial year 2019-20. R S Shah & Associates have been appointed as the Auditors of the Company.**

**Para 1**

**Its Authorized Capital was Rs. 75 Lacs. Subsequently it increased its Share Capital. They issued Shares at a premium of Rs.25/- per share. The Company has transferred the amount received as premium to the Securities Premium Account.**

**Para 2**

**CA R recommended his Engagement Team to prepare an Audit Strategy as well as Audit plan for efficient conduct of audit. He advised to the team that they should include a series of verification procedures to be applied to Financial Statements of the Company for accomplishing the Audit objectives. CA R illustrated to his team the relationship between Audit strategy as well as Audit plan.**

**Para 3**

**Encompassed by a huge clientele, one of the Auditee firm was a LLP. It was in the name of Mangaldeep Geotech LLP. They conducted the business in a very efficient way but had allotted only the Audit and the Income Tax work to CA R S Shah & Associates. The Partners of the LLP were capable enough but however inadvertently bypassed the ROC Compliances. They had no knowledge about the Compliances and its related penalties. Thus they approached CA R S Shah and Associates for their guidance. They were completely clueless as to filing of Annual Return with ROC.**

**Para 4**

**R S Shah and Associates have been appointed as Auditors of a large Enterprise namely Search Results Ltd. Considering the overhaul required in the Organization's Risk Management, Directors of the listed companies braced the subject of Internal Financial Control with much seriousness and rigor. The dawn of the Financial Year lays down the daunting task of establishing and implementing Internal Financial Control in an Enterprise.**

**Para 5**

**The Auditors are performing their Audit work in the Company Search Results Ltd by using CAAT's. The Company is completely automated and all the processes, operations are carried out using the Computer systems. Testing is performed in an automated environment to increase the efficiency and allow for more robust tools to be built. There are four types of testing methods in an Automated environment. They are Inquiry, Observation, Inspection and Re-performance.**

**Q. With reference to para 4, which of the following point ensures implementation of policies and procedures with regard to Internal Financial Control by the Companies?**

**(a) Reliability of Financial Reporting**

**(b) Effectiveness and efficiency of operations**

**(c) Compliance with applicable laws and regulations**

**(d) All of the above.**

Ans. (d)

**Q11. (MTP 2) A Partnership Firm of Chartered Accountants by the name of S K and Associates were appointed as the Auditors of the Company named Big Box Ltd.**

**Para 1**

**Big Box Ltd is a Public Listed Company. The CA Firm comprised of 2 partners namely CA S and CA K. Subsequently, a close relative of CA K, acquired security having face value Rs.495000/- of Big Box Ltd. As per the provisions of Section 141 of the Companies Act 2013, an Auditor will be disqualified from appointment, if the Auditor himself or his relative acquires the security exceeding the prescribed limit in the Company.**

**Para 2**

**Further, the Auditors, S K and Associates also had to bank on the policies and procedures adopted by the Company for ensuring the efficient conduct of its business. They have to state about the adequacy of Internal Financial Controls in the Company.**

**The Company had a turnover of Rs. 60 Crores as per the latest Audited Balance Sheet and its Borrowings during the year were Rs. 20 Crores from Banks.**

**Para 3**

**The CFO of the Company, Mrs. Darshana felt dubious in the Accounts department of the Company. She entreated the Auditors to perform a thorough investigation of the Accounts department. Mrs. Darshana was also anticipating a fraud in this situation. Both the Auditor as well as the CFO of the Company analyzed the various risk factors. The Auditors observed that the Head Accountant of the Department has inflated the Sales amount to finish his targets. There was collusion between the Head Accountant & Employees of the Company. Employees were presented incentives on accomplishing their targets. This resulted in a fraud by the Head Accountant of amount aggregating to Rs.75 Lacs.**

**Para 4**

**Mr. X, an acquaintance of CA S, wanted to form an LLP with his distant relatives. He wanted to possess in- depth knowledge about LLP. CA S explained him that LLP is a separate legal structure and is liable to full extent of its assets but the partners are liable to the extent of their agreed contribution in LLP. Mr. X additionally wanted to know the criteria for the accounts of LLP to be audited. CA S enlightened him that the accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.**

**Para 5**

**Big Box Ltd. is expanding its business. Consequently it requires many Computers. Purchasing computers may involve paying a huge upfront cost. Cash flow may get disrupted. Hence the Company came up with an idea of getting the Computers on lease. It will allow the businesses to have access to the latest technology without harming their cash flow. The Auditors explained to the Directors that leasing Computers shall come under the purview of Operating Lease.**

**Q. The Auditors of S K and Associates were doubtful concerning the applicability of Internal Financial Controls in the Company Big Box Ltd. With reference to details provided in Para 2 above, please guide them in this regard.**

**(a) It will be applicable as Turnover exceeds the threshold limit of Rs.50 Crores.**

**(b) It is not applicable as the Borrowings are less than 25 Crores during the financial year.**

**(c) It will be applicable as the Company is a Public Listed Company.**

**(d) Reporting on Internal Financial Control is not under the scope of Auditors reporting. Hence, Not Applicable.**

Ans. (c)

**Q12. Significant risks often relate to significant non- routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.**

**In context of significant risk, explain the factors to be considered by the auditor in exercising judgment as to which risks are significant risks. (RTP Nov21)**

Ans. 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 ris k.

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

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

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

(c) The complexity of transactions;

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

(e) 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

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

**Q13. Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as complex calculations. Also, risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as accounting principles for accounting estimates may be subject to differing interpretation etc. Explain in detail. (RTP Nov21)**

Ans. Risks of Material Misstatement– Greater for Significant Non-Routine Transactions

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

- Greater management intervention to specify the accounting tfollowing
- Greater manual intervention for data collection and processing.
- Complex calculations or accounting principles.
- The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Risks of material misstatement– Greater for Significant Judgmental Matters

Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interprfollowin
- Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

**Q14. Explain clearly the difference between Internal Financial Control and Internal Controls over financial reporting. (RTP Nov21)**

Ans. Internal Financial Control as per Section 134(5)(e), “the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”

On the other hand, Internal controls over financial reporting-is required where auditors are required to express an opinion on the effectiveness of an entity’s internal controls over financial reporting, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements.

**Q15 . Auditor’s reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Explain in detail quoting specifically the Law in the above context covering each and every aspect (RTP nov21)**

Ans. Auditor’s reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143.

Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

Objectives of an auditor in an audit of internal financial controls over financial reporting: The auditor’s objective in an audit of internal financial controls over financial reporting is, “ to express an opinion on the effectiveness of the company’s internal financial controls over financial reporting.” It is carried out along with an audit of the financial statements.

Reporting under Section 143(3)(i) is dependent on the underlying criteria for internal financial controls over financial reporting adopted by the management. However, any system of internal controls provides only a reasonable assurance on achievement of the objectives for which it has been established. Also, the auditor shall use the concept of materiality in determining the extent of testing such controls.

Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements.

The inclusion of the matters relating to internal financial controls in the directors responsibility statement is in addition to the requirement of the directors stating that they have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the 2013 Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

**Q16. Auditor GR and Associates have been appointed to conduct audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditors do not think that it would be necessary to understand internal controls. Advise the auditor in this regard explaining clearly the benefits of understanding the internal control. (RTP May21)**

Ans. The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

Benefits of Understanding the Internal Control

An understanding of internal control assists the auditor in:

(i) identifying types of potential misstatements;

(ii) identifying factors that affect the risks of material misstatement, and

(iii) designing the nature, timing, and extent of further audit procedures.

**Q17. Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as materiality, the significance of the related risk etc. Explain in detail.(RTP May 21)**

Ans. Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- Materiality.
- The significance of the relMaterialit
- The size of the entity.
- The nature of the entity's business, including its organisation and ownership characteristics.
- The diversity and complexity of the entity's operations.
- Applicable legal and regulatory requirements.
- The circumstances and the applicable component of internal control.
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement. (May21)

**Q18. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this**

**regard. (RTP May21)**

Ans. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following are as:

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

(b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

(c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;

(d) How the information system captures events and conditions that are significant to the financial statements;

(e) The financial reporting process used to prepare the entity's financial statements;

(f) Controls surrounding journal entries.

**Q19. The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. Explain in detail stating clearly the meaning of control activities and also discuss control activities that are relevant to the audit. (RTP May21)**

Ans. The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement.

An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financialstatements and the assertions which the auditor finds relevant in his risk assessment process.

Control activities are the policies and procedures that help ensure that management directives are carried out.

Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.

Examples of specific control activities include those relating to the following:

Control activities that are relevant to the audit are:

• Control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or

• Those that are considered to be relevant in the judgment of the auditor;

• 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.

**Q.20 (a) The risks of material misstatement may exist at the financial statement level and assertion level. Explain the two levels.**

**(b) For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall identify risks throughout the process of obtaining an understanding of the entity and its environment. Explain in detail along with other relevant points.(Rtp Nov 20)**

Ans(a) Risks of Material Misstatement at Two levels

The risks of material misstatement may exist at two levels:

(i) The overall financial statement level- Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

(ii) The assertion level for classes of transactions, account balances, and disclosures-Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

(b) For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:

(a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;

(b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;

(c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and

(d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

**Q21 (a) Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.**

**Explain with the help of examples.**

**(b) Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Explain in detail.(RTP NOV 20)**

Ans(a) Inquiries of Management and Others Within the Entity: Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.

Examples

 Inquiries directed towards those charged with governance may help the Auditor understand the environment in which the financial statements are Prepared.

 Inquiries directed toward internal audit personnel may provide information About internal audit procedures performed during the year relating to the design And effectiveness of the entity's internal control and whether management Has satisfactorily responded to findings from those procedures.

 Inquiries of employees involved in initiating, processing or recording complex Or unusual transactions may help the auditor to evaluate the appropriateness Of the selection and application of certain accounting policies.

 Inquiries directed toward in-house legal counsel may provide information About such matters as litigation, compliance with laws and regulations, Knowledge of fraud or suspected fraud affecting the entity, warranties, post-Sales obligations, arrangements (such as joint ventures) with business

Partners and the meaning of contract terms.

 Inquiries directed towards marketing or sales personnel may provide

Information about changes in the entity's marketing strategies, sales trends,

Or contractual arrangements with its customers.

 Inquiries directed to the risk management function (or those performing such

Roles) may provide information about operational and regulatory risks that

May affect financial reporting.

 Inquiries directed to information systems personnel may provide information

About system changes, system or control failures, or other information

System- related risks.

**(c)** Analytical procedures performed as risk assessment procedures may identify aspects Of the entity of which the auditor was unaware and may assist in assessing the risks Of material misstatement in order to provide a basis for designing and implementing Responses to the assessed risks. Analytical procedures performed as risk assessment Procedures may include both financial and non-financial information, for example, the Relationship between sales and square footage of selling space or volume of goods Sold.

Analytical procedures may help identify the existence of unusual transactions or Events, and amounts, ratios, and trends that might indicate matters that have audit Implications. Unusual or unexpected relationships that are identified may assist the Auditor in identifying risks of material misstatement, especially risks of material Misstatement due to fraud.

However, when such analytical procedures use data aggregated at a high level (which May be the situation with analytical procedures performed as risk assessment Procedures), the results of those analytical procedures only provide a broad initial

Indication about whether a material misstatement may exist. Accordingly, in such Cases, consideration of other information that has been gathered when identifying the Risks of material misstatement together with the results of such analytical procedures May assist the auditor in understanding and evaluating the results of the analytical Procedures.

**Q22 (a) When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain**

**(B) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples.(RTP MAY 20)**

Ans.(a) Control risk assessment when control deficiencies are identified: When auditor Identifies deficiencies and report on internal controls, he determines the significant Financial statement assertions that are affected by the ineffective controls in order to Evaluate the effect on control risk assessments and strategy for the audit of the Financial statements.

When control deficiencies are identified and auditor identifies and tests more than One control for each relevant assertion, he evaluates control risk considering all of The controls he has tested. If auditor determines that they support a 'rely on controls' Risk assessment, or if compensating controls are identified, tested and evaluated to Be effective, he may conclude that the 'rely on controls' is still appropriate. Otherwise We change our control risk assessment to 'not rely on controls.'

When a deficiency relates to an ineffective control that is the only control identified

For an assertion, he revises risk assessment to 'not rely on controls' for associated Assertions, as no other controls have been identified that mitigate the risk related to The assertion. If the deficiency relates to one WCGW (what can go wrong) out of Several WCGW's, he can 'rely on controls' but performs additional substantive Procedures to adequately address the risks related to the deficiency.

(b) Obtaining an understanding of the entity and its environment, including the entity's

Internal control, is a continuous, dynamic process of gathering, updating and Analysing information throughout the audit. The understanding establishes a frame of Reference within which the auditor plans the audit and exercises professional Judgment throughout the audit, for example, when:

-  Assessing risks of material misstatement of the financial statements;
-  Determining materiality in accordance with SA 320;
-  Considering the appropriateness of the selection and application of accounting Policies;
-  Identifying areas where special audit consideration may be necessary, for Example, related party transactions, the appropriateness of management's use Of the going concern assumption, or considering the business purpose of Transactions;
-  Developing expectations for use when performing analytical procedures;
-  Evaluating the sufficiency and appropriateness of audit evidence obtained, such As the appropriateness of assumptions and of management's oral and written Representations.

**Q.23 (a) Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control.**

**(b) It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Explain with the help of example in respect of the procedure for sales.(RTP MAY 20)**

Ans.(a) Objectives of Internal Control

Internal control over safeguarding of assets against unauthorised acquisition, use, or Disposition may include controls relating to both financial reporting and operations Objectives. The auditor’s consideration of such controls is generally limited to those Relevant to the reliability of financial reporting. For example, use of acces s controls, Such as passwords, that limit access to the data and programs that process cash Disbursements may be relevant to a financial statement audit. Conversely, Safeguarding controls relating to operations objectives, such as controls to prevent The excessive use of materials in production, generally are not relevant to a financial Statement audit.

Objectives of Internal Control are :

(i) Transactions are executed in accordance with managements general or specific Authorization;

(ii) All transactions are promptly recorded in the correct amount in the appropriate Accounts and in the accounting period in which executed so as to permit Preparation of financial information within a framework of recognized accounting Policies and practices and relevant statutory requirements, if any, and to Maintain accountability for assets;

(iii) Assets are safeguarded from unauthorised access, use or disposition; and

(iv) The recorded assets are compared with the existing assets at reasonable Intervals and appropriate action is taken with regard to any differences.

**(c)** It has been suggested that actual operation of the internal control should be tested

By the application of procedural tests and examination in depth. Procedural tests Simply mean testing of the compliance with the procedures laid down by the Management in respect of initiation, authorisation, recording and documentation of Transaction at each stage through which it flows.

For example, the procedure for sales requires the following:

1. Before acceptance of any order the position of inventory of the relevant article Should be known to ascertain whether the order can be executed in time.
2. An advice under the authorisation of the sales manager should be sent to the Party placing the order, internal reference number, and the acceptance of the Order. This advice should be prepared on a standardised form and copy thereof Should be forwarded to inventory section to enable it to prepare for the execution Of the order in time.
3. The credit period allowed to the party should be the normal credit period. For Any special credit period a special authorisation of the sales manager would be Necessary.
4. The rate at which the order has been accepted and other terms about transport, Insurance, etc., should be clearly specified.
5. Before deciding upon the credit period, a reference should be made to the credit Section to know the creditworthiness of the party and particularly whether the Party has honoured its commitments in the past.

# Chapter 5 - Fraud and Responsibilities of the Auditor in this Regard.

**Q1. State with reasons whether this statement is correct or incorrect.**

**“Misstatement in the financial statements is always because of a fraud”. (July 21 Attempt)**

Ans. **Incorrect:** Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of financial statements is intentional or unintentional. Hence misstatement can arise from error or fraud.

**Alternative solution:** Misstatement refers to a difference between the amount, classification, presentation or disclosure of a reported financial statement item and the amount, classification presentation or disclosure that is required for the item to be in accordance with the applicable financial reporting frame work. Hence misstatement can arise from error or fraud.

**Q2. List out any three circumstances which induce the management/ employee to commit the fraud. (July 21 Attempt)**

Ans. Circumstances which induce the management/ employee to commit fraud are :

-  Financial obligations/ Pressure.
-  Management’s unrealistic goals.
-  Dissatisfied Employees or Lack of motivation among employees.
-  Name game (eg. management using power of authority by asking employees to do something illegal).
-  Opportunity to commit fraud.

**Q3. M/s PQR & Associates is appointed as the new auditors of M/s Prince Ltd. On conducting the audit, the firm found that the accountant has entered fake invoices of**

**credit purchases in the books of a ccounts aggregated of ₹ 75 Lakhs and cleared all the payments to the fake creditor. The auditor M/s PQR & Associates should report such fraud to : (MTP)**

**(a) Central Government**

**(b) Reserve Bank of India**

**(c) Board of Directors/Audit Committee**

**(d) Comptroller & Auditor General**

Ans. (c)

**Q4. Examine with reason (in short) whether the following statement is correct or incorrect :**

**Satisfactory Control environment is an absolute deterrent to fraud.(MTP)**

Ans, **Incorrect:** The existence of a Satisfactory Control environment can be a positive factor when an auditor assesses the risk of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory Control environment is not an absolute deterrent to fraud.

**Q5. Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great fact and intelligence. Explain stating the objective behind committing such fraud. (MTP)**

Ans. Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way. This type of fraud is generally committed:

(a) to avoid incidence of income-tax or other taxes;

(b) for declaring a dividend when there are insufficient profits;

(c) to withhold declaration of dividend even when there is adequate profit (this is often done to manipulate the value of shares in stock market to make it possible for selected persons to acquire shares at a lower cost); and

(d) for receiving higher remuneration where managerial remuneration is payable by reference to profits.

**Q6. Examine with reason (in short) whether the following statement is correct or incorrect :**

**Intentional errors are most difficult to detect and auditors generally devote greater attention to this type. (MTP 2)**

Ans. **Correct:** Intentional errors are most difficult to detect and auditors generally devote greater attention to this type because out of long and sometimes unfortunate experience, auditors have developed a point of view that, if they direct their procedures of discovering the more difficult intentional errors, they are reasonably certain to locate the more simple and far more common unintentional errors on the way.

**Q7. Fraud in the form of misappropriation of goods is still more difficult to detect. Explain. (MTP 2)**

Ans. Fraud in the form of misappropriation of goods is still more difficult to detect; for this, management has to rely on various measures. Apart from the various requirements of record keeping about the physical quantities and their periodic checks, there must be rules and procedures for allowing persons inside the area where goods are kept. In addition there should be external security arrangements to see that no goods are taken out without proper authority. Goods can be anything in the premises; it may be machinery. It may even be the daily necessities of the office like stationery. The goods may be removed by subordinate employees or even by persons quite higher up in the management. Auditors can detect this by undertaking a thorough and strenuous checking of records followed by physical verification process. Also, by resorting to intelligent ratio analysis, auditors may be able to form an idea whether such fraud exists.

**Q8. (MTP 2) A Partnership Firm of Chartered Accountants by the name of S K and**

**Associates were appointed as the Auditors of the Company named Big Box Ltd.**

**Para 1**

**Big Box Ltd is a Public Listed Company. The CA Firm comprised of 2 partners namely CA S and CA K. Subsequently, a close relative of CA K, acquired security having face value Rs.495000/- of Big Box Ltd. As per the provisions of Section 141 of the Companies Act 2013, an Auditor will be disqualified from appointment, if the Auditor himself or his relative acquires the security exceeding the prescribed limit in the Company.**

**Para 2**

**Further, the Auditors, S K and Associates also had to bank on the policies and procedures adopted by the Company for ensuring the efficient conduct of its business. They have to state about the adequacy of Internal Financial Controls in the Company. The Company had a turnover of Rs. 60 Crores as per the latest Audited Balance Sheet and its Borrowings during the year were Rs. 20 Crores from Banks.**

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**The CFO of the Company, Mrs. Darshana felt dubious in the Accounts department of the Company. She entreated the Auditors to perform a thorough investigation of the Accounts department. Mrs. Darshana was also anticipating a fraud in this situation. Both the Auditor as well as the CFO of the Company analyzed the various risk factors. The Auditors observed that the Head Accountant of the Department has inflated the Sales amount to finish his targets. There was collusion between the Head Accountant & Employees of the Company. Employees were presented incentives on accomplishing their targets. This resulted in a fraud by the Head Accountant of amount aggregating to Rs.75 Lacs.**

**Para 4**

**Mr. X, an acquaintance of CA S, wanted to form an LLP with his distant relatives. He**

**wanted to possess in- depth knowledge about LLP. CA S explained him that LLP is a separate legal structure and is liable to full extent of its assets but the partners are liable to the extent of their agreed contribution in LLP. Mr. X additionally wanted to know the criteria for the accounts of LLP to be audited. CA S enlightened him that the accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.**

**Para 5**

**Big Box Ltd. is expanding its business. Consequently it requires many Computers. Purchasing computers may involve paying a huge upfront cost. Cash flow may get disrupted. Hence the Company came up with an idea of getting the Computers on lease. It will allow the businesses to have access to the latest technology without harming their cash flow. The Auditors explained to the Directors that leasing Computers shall come under the purview of Operating Lease.**

**Q. With reference to para 3, wherein a fraud was observed by the Auditor, what should be the course of action of the Auditor?**

**(a) The Auditor should report the fraud details to Central Government.**

**(b) The Auditor shall report the fraud to the audit Committee or to the Board within the prescribed time.**

**(c) The Auditor shall disclose it in the Audit Report and report the fraud details to RBI too.**

**(d) Both a & c above.**

Ans. (b)

**Q9. Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way. Explain why such frauds are committed. (RTP Nov21)**

Ans. Detection of manipulation of accounts with a view to presenting a false state of affairs is atask requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way. This type of fraud is generally committed:

(a) to avoid incidence of income-tax or other taxes;

(b) for declaring a dividend when there are insufficient profits;

(c) to withhold declaration of dividend even when there is adequate profit (this is often done to manipulate the value of shares in stock market to make it possible for selected persons to acquire shares at a lower cost); and

(d) for receiving higher remuneration where managerial remuneration is payable by reference to profits.

**Q10. Misappropriation of assets involves the theft of an entity's assets and is often perpetrated**

**by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways**

**that are difficult to detect.**

**Misappropriation of assets can be accomplished in a variety of ways. Explain those particular ways. (RTP Nov21)**

Ans. Misappropriation of assets involves the theft of an entity's assets and is often perpetrated
by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:

➢ Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).

➢ Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

➢ Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).

➢ Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper aauthorization.

**Q11. Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart**
**from reporting the existence of fraud, also report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016, the nature of fraud and amount involved.**

**Explain the considerations an auditor would keep in mind for reporting under this clause.(RTP May21)**

Ans. Where the auditor notices that any fraud by the company or on the company by its officers
or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also required to report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016, the nature of fraud and amount involved.

For reporting under this clause, the auditor may consider the following:

(i) This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified the fraud by the company or on the company by its officers or employees are only covered.(ii) Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be
included here and not the suspected frauds.

(iii) While reporting under this clause with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing.

**Q12. The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. Explain. (RTP May21)**

Ans. The 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

behavior 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.

**Q13. Explain what an auditor is expected to do if, as a result of a misstatement resulting from Fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into Question the auditor's ability to continue performing the audit.(RTP NOV 20)**

Ans. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor Encounters exceptional circumstances that bring into question the auditor's ability to Continue performing the audit, the auditor shall:

(a) Determine the professional and legal responsibilities applicable in the circumstances, Including whether there is a requirement for the auditor to report to the person or Persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) Consider whether it is appropriate to withdraw from the engagement, where Withdrawal is possible under applicable law or regulation; andIf the auditor withdraws:

(i) Discuss with the appropriate level of management and those charged with Governance the auditor's withdrawal from the engagement and the reasons for The withdrawal; and

(ii) Determine whether there is a professional or legal requirement to report to the Person or persons who made the audit appointment or, in some cases, to

Regulatory authorities, the auditor's withdrawal from the engagement and the Reasons for the withdrawal.

**Q14. As per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall reportthe matter to the Central Government within such time and in such manner as may be prescribed. In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ` 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.**

**Explain the manner of reporting the matter to the Central Government in the above context.(RTP NOV 20)**

Ans The manner of reporting the matter to the Central Government is as follows:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit

Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(c) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed Cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

€ the report shall be on the letter-head of the auditor containing postal address, e-mail Address and contact telephone number or mobile number and be signed by the Auditor with his seal and shall indicate his Membership Number; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

**Q15. Auditor of A Ltd while conducting audit in the course of the performance of his duties as auditor, believes with reasons that "an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed". Analyse and also explain the manner of reporting the matter to the Central Government(RTP MAY 20)**

Ans.Reporting to the Central Government: As per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company in the course of the performance of his Duties as auditor, has reason to believe that an offence of fraud involving such amount or Amounts as may be prescribed, is being or has been committed in the company by its Officers or employees, the auditor shall report the matter to the Central Government within Such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been Prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course

Of the performance of his duties as statutory auditor, has reason to believe that an offence Of fraud, which involves or is expected to involve individually an amount of ` 1 crore or Above, is being or has been committed against the company by its officers or employees, The auditor shall report the matter to the Central Government.

The manner of reporting the matter to the Central Government is as follows:

(a) The auditor shall report the matter to the Board or the Audit Committee, as the case May be, immediately but not later than 2 days of his knowledge of the fraud, seeking Their reply or observations within 45 days;

(b) On receipt of such reply or observations, the auditor shall forward his report and the Reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

© in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was Earlier forwarded to the Board or the Audit Committee for which he has not received Any reply or observations;

(c) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed Cover by Registered Post with Acknowledgement Due or by Speed Post followed by An e-mail in confirmation of the same;

€ the report shall be on the letter-head of the auditor containing postal address, e-mail Address and contact telephone number or mobile number and be signed by the Auditor with his seal and shall indicate his Membership Number; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

**Q16. Discrepancies in the accounting records, including transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy is one of the example of circumstances that indicate the possibility of fraud. Explain at least four other such examples relating to discrepancies in the accounting records.(RTP MAY 20)**

ANS Discrepancies in the accounting records, including:

• Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.

• Unsupported or unauthorized balances or transactions.

• Last-minute adjustments that significantly affect financial results.

• Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties

.•Tips or complaints to the auditor about alleged fraud.

# Chapter 06 : Audit in an Automated Environment

**Q1. State with reason whether the statement is correct or incorrect.**

**"With reference to General IT control, the objective of Data Center and Network Operations is to ensure that systems are developed, configured and implemented to meet financial reporting objectives". (July 21 Attempt)**

Ans. **Incorrect:** Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives.

Objective of Application system acquisition, development, and maintenance is to ensure that systems are developed, configured and implemented to meet financial reporting objectives.

**Q2. Foreceful Limited is a company dealing in mobile spare parts and having its showrooms in almost all the states in the country. For FY 2020-21, the company transferred its accounts from manual to computerized system (SAP). PQR & Co., Chartered Accountants have specialization in the system audit and have been appointed as the system auditor. PQR & Co., at the end of the audit concludes that there are certain findings or exceptions in IT environment and IT controls of the company which needs to be assessed and reported. Mention those points of consideration. (July 21 Attempt)**

Ans. At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders including management and those charged with governance viz., Board of directors, Audit committee.

**Some points to consider are as follows**:

- Are there any weaknesses in IT controls?
- What is the impact of these weaknesses on overall audit?

- Report deficiencies to management – Internal Controls Memo or Management Letter.
- Communicate in writing any significant deficiencies to Those Charged With

Governance.

The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.

**Q3. Examine with reason (in short) whether the following statement is correct or incorrect :**

**When auditing in an automated environment, inquiry is often the most efficient and effective audit testing method. (MTP)**

Ans. **Incorrect:** There are basically four types of audit tests that should be used in an automated environment. They are inquiry, observation, inspection and re-performance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Applying inquiry in combination with inspection gives the most effective and efficient audit evidence.

**Q4. List any five points that an auditor should consider to obtain an understanding of the Company's automated environment. (MTP)**

Ans. **Understanding of the Company's Automated Environment:** Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment

• Information systems being used (one or more application systems and what they are)

• their purpose (financial and non-financial)

• Location of IT systems - local vs global

• Architecture (desktop based, client-server, web application, cloud based)

• Version (functions and risks could vary in different versions of same application)

• Interfaces within systems (in case multiple systems exist)

• In-house vs Packaged

• Outsourced activities (IT maintenance and support)

• Key persons (CIO, CISO, Administrators

**Q5. Examine with reasons (in short) whether the following statements are correct or incorrect (MTP 2)**

**All automated environments are not complex.**

Ans. **Correct:** The complexity of an automated environment depends on various factors including the nature of business, level of automation, volume of transactions, use of ERP and so on. There could be environment where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.

**A combination of processes, tools and techniques that are used to tap vast amount of electronic data to obtain meaningful information is known as meaningful data.**

Ans. **Incorrect:** A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as Data Analytics.

**When auditing in an automated environment, inquiry is often the most efficient and effective audit testing method.**

Ans**. Incorrect:** There are basically four types of audit tests that should be used in an automated environment. They are inquiry, observation, inspection and re-performance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Applying inquiry in combination with inspection gives the most effective and efficient audit evidence.

**Q6. Describe how risks in IT systems, if not mitigated, could have an impact on audit. (MTP 2)**

Ans. When risks in IT systems are not mitigated the audit impact could be as follows:

(i) The auditor may not be able rely on the reports, data obtained, automated controls, calculations and accounting procedures in the IT system.

(ii) The auditor has to perform additional audit work by spending more time and efforts.

(iii) The auditor may have to issue a modified opinion, if necessary.

**Q7. The auditor should consider relevance of IT in an audit of financial statements. Explain giving reasons. (RTP Nov21)**

Ans. The auditor should consider relevance of IT in an audit of financial statements for the following reasons:

(a) Since auditors rely on the reports and information generated by IT systems, there could be risk in the IT systems that could have an impact on audit.

(b) Standards on auditing SA 315 and SA 330 require auditors to understand, assess and respond to risks that arise from the use of IT systems.

(c) By relying on automated controls and using data analytics in an audit, it is possible to increase the effectiveness and efficiency of the audit process.

**Q8. Describe how risks in IT systems, if not mitigated, could have an impact on audit.(RTP Nov21)**

Ans. When risks in IT systems are not mitigated the audit impact could be as follows:

(i) First, auditors may not be able to rely on the data obtained from systems where such risks exist. This means, all forms of data, information or reports that they obtain from systems for the purpose of audit has to be thoroughly tested and corroborated for completeness and accuracy.

(ii) Second, auditors will not be able to rely on automated controls, calculations, accounting procedures that are built into the applications. Additional audit work may be required in this case.

(iii) Third, due to the regulatory requirement of auditors to report on internal financial controls of a company, the audit report also may have to be modified in some instances.

**Q9. Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives. Discuss the activities performed by Data Center and Network operations. Also explain the meaning of General IT Controls in detail.(RTP May21)**

Ans. "General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments.

General IT-controls that maintain the integrity of information and security of data commonly include controls over the following:"

(i) Data center and network operations

(ii) Program change

(iii) Access security

(iv) Application system acquisition, development, and maintenance (Business Applications)

These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls. Let us now learn about each of the General IT controls in more detail.

Data Center and Network Operations

Objective: To ensure that production systems are processed to meet financial reporting objectives.

Activities:

1. Overall Management of Computer Operations Activities

2. Batch jobs – preparing, scheduling and executing

3. Backups – monitoring, storage & retention

4. Performance Monitoring – operating system, database and networks

5. Recovery from Failures – BCP, DRP

6. Help Desk Functions – recording, monitoring & tracking

7. Service Level Agreements – monitoring & compliance

8. Documentation – operations manuals, service reports

**Q10. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the selection of audit samples. Explain giving other relevant points also in the above context of data analytics (RTP May21)**

Ans. Data analytics can be used in testing of electronic records and data residing in IT systems

using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following:

- Check completeness of data and population that is used in either test of controls or substantive audit tests.
- Selection of audit samples – random sampling, systematic samptests
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Reperformance of mathematical calculations – depreciation, bank interest calculatiodat
- Analysis of journal entries as required by SA 240.
- Fraud investigation.
- Evaluating impact of control deficiencies.

# Chapter 7- Audit Sampling

**Q1. State with reason whether the statement is correct or incorrect.**

**"In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population". (July 21 Attempt)**

Ans. **Incorrect:** In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.

**Q2. CA B is appointed as an auditor of M/s Divine Pharmacy, a wholesale medicine supplier. While auditing for the financial year 2020-21, CA B wants to use test checking technique. Advise CA B, what kind of precautions should be taken by him in this regard. (July 21 Attempt)**

Ans. While auditing the accounts of Divine Pharmacy, CA B wanted to use Test Checking technique. The following precautions should be taken by CA B while applying test check techniques:

- Thorough study of accounting system should be done before adopting sampling.
- Proper study of internal control systems.
- Areas which are not suitable for sampling should be carefully considered, eg: compliance with statutory provisions, transactions of unusual nature etc.
- Proper planning for Sampling methods to be used and explaining the staff,
- Transactions and balances have to be properly classified (stratified)
- Sample size should be appropriately determined.
- Sample should be chosen in unbiased way.
- Errors located in the sample should be analyzed properly.

**Q3. State the requirements related to audit sampling, sample design, sample size and**

**selection of items for testing. (MTP)**

Ans. **Audit Sampling:** As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is – the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population. The requirements relating to sample design, sample size and selection of items for testing are explained below-

**Sample design -** When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.

**Sample Size-** The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

**Selection of Items for Testing-** The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

**Q4. CA X is not sure about the kind of Sampling method to be used for audit of a company. Advise him about the choice of methods (name of methods only) of Sampling to be used in various circumstances. Also explain briefly the advantages of Sampling to be used by him in auditing. (MTP 2)**

Ans. **Sample Selection:**

CA. X should obtain the knowledge before using the sampling methods. The principal methods are as follows:

(1) Random selection.

(2) Systematic selection.

(3) Monetary Unit sampling.

(4) Haphazard selection.

(5) Block selection.

**Advantages of Statistical Sampling in Audit:**

(i) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.

(ii) The sample selection is more objective and thereby more defensible.

(iii) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.

(iv) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.

(v)It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

**Q5. When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. Explain in detail. (RTP NOV21)**

Ans. Audit sampling enables 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 from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling. In fulfilling the requirement of relevant portion (paragraph 8) of SA 500, when performing audit sampling, the auditor performs audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.

The auditor's consideration of the purpose of the audit procedure includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the purpose of the audit procedure are included in the evaluation of deviations or projection of misstatements. For example, in a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after that date by the client, are not considered a misstatement. Also, a misposting between customer accounts does not affect the total accounts receivable balance. Therefore, it may not be appropriate to consider this a misstatement in evaluating the sample results of this particular audit procedure, even though it may have an important effect on other areas of the audit, such as the assessment of the risk of fraud or the adequacy of the allowance for doubtful accounts.

In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the relevant controls or on the examination of a small number of items from the population. This assessment is made in order to design an audit sample and to determine sample size. For example, if the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100% examination or use of a large sample size may be appropriate when performing tests of details.

In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

**Q6. In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. Guide the auditor on the use of stratification and value-weighted sampling techniques. (RTP Nov21)**

Ans. In considering the characteristics of the population from which the sample will be drawn,

the auditor may determine that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value -

weighted sampling techniques.

Stratification: Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic.

The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement.

Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.

Dividing a population into discrete sub population which have identifying characteristics is called as Stratification. Each Sub population is called as Stratum and units under those sub population are referred to as Strata.

The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population.

The results of samples from the units drawn under each sub population are projected to that respective stratum. In order to draw an opinion on the overal l population, the auditor needs to combine the results of all the stratum to check for possible deviation or risk of material misstatement.

Projected misstatements of each stratum will be combined together to consider the possible effect of misstatement in the account balances and class of transactions.

Example

20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).

Value-Weighted Selection: When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units.

One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes.

This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.

In value weighted selection, the sample size, its selection and evaluation will result in a conclusion in monetary amounts.

**Q7. Explain the following terms with reference to Audit Sampling :**

**(i) Stratification**

**(ii) Tolerable misstatement**

**(iii) Tolerable rate of deviation (RTP May21)**

Ans. (i) Stratification – The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

(ii) Tolerable misstatement – A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

(iii) Tolerable rate of deviation – A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain anappropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

**Q8. In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries. Explain in detail. (RTP MAY21)** Ans. In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries.

Auditors realised that they can derive good satisfaction by undertaking a much lesser checking by adoption of this technique in the auditing process. It is a mathematical truth that the sample, if picked purely on a random basis would reveal the features and characteristics of the population.

By adopting the sampling technique, the auditor only checks a part of the whole mass of transactions. The satisfaction he used to derive earlier, by checking all the transactions, can be derived by a sample checking provided he can put reliance on the internal controls and checks within the client's organisation because they provide the reliability of the records. Sampling is used as a part of Test of controls. Auditor will check few internal controls and their operating effectiveness. Based on the conclusion derived, he can then design the sample size for test of details (i.e checking of transactions and balances)

If the internal control is satisfactory in its design and implementation, a much smaller sample can give the auditor the necessary reliability of the result he obtains.

On the other hand, if in certain areas controls are slack or not properly implemented, the auditor may have to take a much larger sample for getting satisfactory result.

Another truth about the sampling technique should be noted. It can never bring complete reliability; it cannot give precisely accurate results. It is a process of estimation. It may have some error. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular case.

# Chapter 8 - Analytical Procedures

**Q1. The statutory auditor of ABC Ltd., CA Raj identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of ABC Ltd. With reference to SA 520 on "Analytical Procedures", how CA Raj shall investigate such differences? (July 21 Attempt)**

Ans. If analytical procedures performed in accordance with SA 520 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:

(i) **Inquiring of management and obtaining appropriate audit evidence relevant to management's responses:** Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

(ii) **Performing other audit procedures as necessary in the circumstances:** The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

**Conclusion**: In the present case CA Raj identifies certain inconsistencies while applying analytical procedure to financial or non financial data of ABC Ltd. CA Raj should inquire the management of ABC Ltd, and obtain sufficient and appropriate audit evidences relevant to the management response. Further CA Raj should also perform other audit procedures, if required in the circumstances of the case to obtain further sufficient and appropriate evidence.

**Q2. Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances. (MTP)**

Ans. **Analytical Review Procedures:** The following analytical review procedures may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances-

(i) comparison of closing balances of trade receivables, loans and advances with the corresponding figures for the previous year;

(ii) comparison of the relationship between current year trade receivable balances and the current year sales with the corresponding budgeted figures, if available;

(iii) comparison of actual closing balances of trade receivables, loans and advances with the corresponding budgeted figures, if available;

(iv) comparison of current year's ageing schedule with the corresponding figures for the previous year;

(v) comparison of significant ratios relating to trade receivables, loans and advances with similar ratios for other firms in the same industry, if available;

(vi) comparison of significant ratios relating to trade receivables, loans and advances with the industry norms, if available.

**Q3. The auditor may choose to analyse the monthly trend for Power & Fuel expense. Explain how this analysis will be performed by the auditor. (MTP 2)**

Ans. **Power and fuel expense -**

• Obtain a month wise expense schedule along with the power bills.

• Verify if expense has been recorded for all 12 months.

• Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis.

•In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends.

**Q4. Explain how the statutory auditor of a company can apply analytical procedures at the planning phase of audit. (MTP 2)**

Ans. Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

**Analytical Procedures in Planning the Audit**

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information. For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions.

**Q5. For the purposes of the SAs, the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Explain giving examples of both. (RTP Nov21)**

Ans. Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

• Comparable information for prior periods.

• Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.

• Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example:

• Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.

• Between financial information and relevant non-financial information, such as payroll costs to number of employees.

**Q6. Analysis by computation of ratios includes the study of relationships between financial statement amounts. State Commonly used ratios. (RTP NOV21)**

Ans. Analysis by computation of ratios includes the study of relationships between financial statement amounts. Commonly used ratios include:

• Elements of income or loss as a percentage of sales

• Gross profit turnover

• Accounts receivable turnover

• Inventory turnover

• Profitability, leverage, and liquidity

**Q7. The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. In this context, discuss the techniques available as Substantive Analytical Procedures. (RTP May21)**

Ans. Techniques available as Substantive Analytical Procedures : The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms:

Trend analysis — A commonly used technique is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.Ratio analysis — Ratio analysis is useful for analysing asset and liability accounts as well

as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

Reasonableness tests — Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts.

Structural modelling — A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

**Q8. Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances (RTP May21)**

Ans. Analytical Review Procedures: The following analytical review procedures may often be

helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances-

(i) comparison of closing balances of trade receivables, loans and advances with the corresponding figures for the previous year;

(ii) comparison of the relationship between current year trade receivable balances and the current year sales with the corresponding budgeted figures, if available;

(iii) comparison of actual closing balances of trade receivables, loans and advances with the corresponding budgeted figures, if available;

(iv) comparison of current year's ageing schedule with the corresponding figures for the previous year;

(v) comparison of significant ratios relating to trade receivables, loans and advances with similar ratios for other firms in the same industry, if available;

(vi) comparison of significant ratios relating to trade receivables, loans and advances with the industry norms, if available.

# Chapter 9 - Audit of Items of Financial Statements

**Q1. State with reason whether the statement is correct or incorrect.**

**"Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur". (July 21 Attempt)**

Ans. **Incorrect:** Assertions refer to representations by management, explicit or otherwise that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

**Q2. CA "X" while conducting an audit of Joyful Ltd. found a considerable increase in sales as compared to the previous year, he doubts that few fictitious sales have been recorded by the company to overstate its revenues. Discuss any four audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated? (July 21 Attempt)**

Ans. CA X, having doubts about fictitious sales being recorded by Joyful Ltd would ensure that revenue is not overstated by performing following audit procedures:

- Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
- Test check few invoices with their relevant entries in sales journal.
- Obtain confirmation from few customers to ensure genuineness of sales transaction
- Whether any fictitious customers and sales have been recorded.
- Whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
- Whether unearned revenue recorded as earned.
- Whether any substantial uncertainty exists about collectability
- Whether customer obligations are contingent on other actions (financing, resale etc.)

**Q3. The value of intangible assets may diminish due to efflux of time, use and/or obsolescence.**

**The diminution of the value represents cost to the entity for earning revenue during a given period. Discuss the audit procedures to be applied by the auditor to ensure that Intangible assets have been valued appropriately and as per generally accepted accounting policies and practices. (July 21 Attempt)**

Ans. The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained and the values of intangible asset would be shown at higher amounts. The auditor should:

- Verify that the entity has charged amortization on all intangible assets;
- Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

The auditor should also verify whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.

**Q4. "While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel but for other expenses, an auditor generally prefers to verify other attributes". Mention those attributes. (MTP)**

Ans. **While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel,** an auditor generally prefers to vouch for other expenses to verify following attributes:

(i) Whether the expenditure pertained to current period under audit;

(ii) Whether the expenditure qualified as a revenue and not capital expenditure;

(iii) Whether the expenditure had a valid supporting like travel tickets, insurance policy , third party invoice etc.;

(iv) Whether the expenditure has been classified under the correct expense head;

(v) Whether the expenditure was authorised as per the delegation of authori ty matrix;

(vi) Whether the expenditure was in relation to the entity's business and not a personal Expenditure

**Q5. In the course of audit of SMP Ltd. for the financial year ended 31 March, 2020 you have observed as an auditor that the company has provided a sum of 20 lakhs in the books of accounts as gratuity payable to employees based on certificate obtained from an actuary. Give your comments with reference to Standard on Auditing. (MTP 2)**

Ans. **Certificate from a Management's Expert:** In the given case, SMP Limited has provided a sum of 20 lakh in the books of accounts as gratuity payable on the basis of certificate obtained from an actuary. The liability towards gratuity payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service, it is an ascertained present liability accruing over the period of service but payable upon cessation of service.

The auditor should check the quantification of the gratuity liability. He should ascertain whether the same had been actuarially determined. The auditor should treat the actuary as managements' expert and conduct procedures relevant to checking the opinion of an expert in accordance with SA 500.

As per SA 500, "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

1. Evaluate the competence, capabilities and objectivity of that expert;

2. Obtain an understanding of the work of that expert; and

3. Evaluate the appropriateness of that expert's work as audit evidence for the relevant

assertion.

**Q6. Management of Z Ltd. wants to include all the cost incurred by the company in valuing the cost of its inventories. The Accountant is, however, of the view that certain costs should be excluded from the cost of inventories and should be recognized as expenses for the period in which they are incurred. What are such costs that should be excluded while determining the cost of inventories? (MTP 2)**

Ans. **Examples of costs to be excluded in determining cost of Inventory:**

In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

(i) abnormal amounts of wasted materials, labour, or other production costs;

(ii) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(iii) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(iv) selling and distribution costs.

In the given situation, contention of Z Ltd. is not correct to include all the cost of its inventories while determining the cost of inventory. However, contention of accountant is correct that certain cost should be excluded from the cost of inventories and to be recognised as expenses in period in which they are incurred.

**Q7. Write the audit procedure for verification of existence of Trade Receivables. (MTP 2)**

Ans. For Verification of Existence of Trade Receivables, the auditor should check the following :

i. Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice. Ask for a period-end accounts receivable aging report and trace the balance as per the report to the general ledger.

ii. Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first.

iii. If any large balance is due for a long time, auditor should ask for reasons and justification for the same.

iv. A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed.

v. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.

vi. Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample.

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vii. Where no reply is received, the auditor should perform alternate procedures regarding the balances. This could include:

viii. Agreeing the balance to cash received subsequently;

ix. Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. (examination in depth for those balances)

x. If there are any related party receivables, review them for collectability as well as whether they were properly authorized and the value of such transactions were reasonable and at arm’s length.

xi. Check that receivables for other than sales or services are not included in the list.

xii. Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e. perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.

**Q8. Statement I : A capital reserve cannot be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.**

**Statement II : The amount of securities premium or capital redemption reserve account can be utilised only for the purposes specified in Sections 52 and 55 of the Companies Act, 2013, respectively.**

**(a) only Statement I is correct**

**(b) only Statement II is correct**

**(c) both the statements are correct**

**(d) both the statements are incorrect**

Ans (b)

**Q9. (MTP 2) A Partnership Firm of Chartered Accountants by the name of S K and Associates were appointed as the Auditors of the Company named Big Box Ltd.**

**Para 1**

**Big Box Ltd is a Public Listed Company. The CA Firm comprised of 2 partners namely CA S and CA K. Subsequently, a close relative of CA K, acquired security having face value Rs.495000/- of Big Box Ltd. As per the provisions of Section 141 of the Companies Act 2013, an Auditor will be disqualified from appointment, if the Auditor himself or his relative acquires the security exceeding the prescribed limit in the Company.**

**Para 2**

**Further, the Auditors, S K and Associates also had to bank on the policies and procedures adopted by the Company for ensuring the efficient conduct of its business. They have to state about the adequacy of Internal Financial Controls in the Company. The Company had a turnover of Rs. 60 Crores as per the latest Audited Balance Sheet**

**and its Borrowings during the year were Rs. 20 Crores from Banks.**

**Para 3**

**The CFO of the Company, Mrs. Darshana felt dubious in the Accounts department of the Company. She entreated the Auditors to perform a thorough investigation of the Accounts department. Mrs. Darshana was also anticipating a fraud in this situation. Both the Auditor as well as the CFO of the Company analyzed the various risk factors. The Auditors observed that the Head Accountant of the Department has inflated the Sales amount to finish his targets. There was collusion between the Head Accountant & Employees of the Company. Employees were presented incentives on accomplishing their targets. This resulted in a fraud by the Head Accountant of amount aggregating to Rs.75 Lacs.**

**Para 4**

**Mr. X, an acquaintance of CA S, wanted to form an LLP with his distant relatives. He wanted to possess in- depth knowledge about LLP. CA S explained him that LLP is a separate legal structure and is liable to full extent of its assets but the partners are liable to the extent of their agreed contribution in LLP. Mr. X additionally wanted to know the criteria for the accounts of LLP to be audited. CA S enlightened him that the accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.**

**Para 5**

**Big Box Ltd. is expanding its business. Consequently it requires many Computers. Purchasing computers may involve paying a huge upfront cost. Cash flow may get disrupted. Hence the Company came up with an idea of getting the Computers on lease. It will allow the businesses to have access to the latest technology without harming their cash flow. The Auditors explained to the Directors that leasing Computers shall come under the purview of Operating Lease.**

**Q. In reference to para 5, which among the following is an INCORRECT trait about the**

**Operating Lease?**

**(a) The Lessee does not have the option to buy the asset during the lease period.**

**(b) The Lessee cannot claim Depreciation on the leased asset.**

**(c) The Lessee generally bears the Insurance, Maintenance and Taxes.**

**(d) The Lease term generally extends to less than 75% of the projected useful life of the leased asset.**

Ans. (c)

**Q10. Explain how you will verify the items given while conducting an audit of an entity:**

**(a) Recovery of Bad debts written off**

**(b) Receipt of Insurance claims**

**(c) Payment of Taxes**

**(d) Sale proceeds of scrap material (RTP Nov21)**

Ans. (a) Recovery of Bad Debts written off: Recovery of bad debts written off is verified with

reference to relevant correspondence and proper authorisation.

(i) Ascertain the total amount lying as bad debts and verify the relevant correspondence with the trade receivables whose accounts were written off as bad debt.

(ii) Ensure that all recoveries of bad debts have been properly recorded in the books of account.

(iii) Examine notification from the Court or from bankruptcy trustee. Letters from collecting agencies or from account receivables should also be seen.

(iv) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.

(v) Vouch acknowledgement receipts issued to account receivables or trustees.

(vi) Review the internal control system regarding writing off and recovery of bad debts

(b) Receipt of Insurance Claims: Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims-

(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 Statement of Profit and Loss is debited with the short fall of the claim admitted against book value, if the claim was lodged in theprevious year but no entries were passed, entries in the Statement of Profit and Loss should be appropriately described.

(c) Payment of Taxes:

(i) Obtain the computation of taxes prepared by the auditee and verify whether it is as per the Income Tax Act/GST Act/ Rules/ Notifications/ Circulars etc.

(ii) Examine relevant records and documents pertaining to payment of advance income tax and self assessment tax.

(iii) Payment on account of income-tax and other taxes like GST consequent upon a regular assessment should be verified by reference to the copy of the assessment order, notice of demand and the receipted challan acknowledging the amount paid.

(iv) The penal interest charged for non-payment should be debited to the interest account.

(v) Nowadays, electronic payment of taxes is also in trend. Such electronic payment of taxes by way of internet banking facility or credit or debit cards shall also be verified.

(vi) The assessee can make electronic payment of taxes also from the account of any other person. Therefore, it should be verified that the challan for making such payment is clearly indicating the PAN No./TAN No./TIN No./GSTIN etc. of the assessee on whose behalf the payment is made.

(d) Sale Proceeds of Scrap Material:

(i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.

(ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.

(iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.

(iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.

(v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.

(vi) See that scrap materials sold have been billed and check the calculations on the invoices.

(vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it and sold as scrap

(viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

**Q11. APQ Ltd. deals in real estate and classifies all of its land holding under current assets as inventory. The same is, therefore valued at cost or market value whichever is**

**less. How would you verify profit or loss arising on sale of plots of land by such a dealer? (rtp Nov21)**

Ans. Verification of Profit & Loss Arising on sale of Plots by real estate dealer: The land holding in the case of real estate dealer will be a current asset and not a fixed asset. The same should, therefore, be valued at cost or market value whichever is less. The amount of profit or loss arising on sale of plots of land by such a dealer should be verified as follows:

(i) Each property account should be examined from the beginning of the development with special reference to the nature of charges so as to find out that only the appropriate cost and charges have been debited to the account and the total cost of the property has been set off against the price realised for it.

(ii) This basis of distribution of the common charges between different plots of land developed during the period, and basis for allocation of cost to individual properties comprised in a particular piece of land should be scrutinised.

(iii) If land price lists are available, these should be compared with actual selling prices obtained. And it should be verified that contracts entered into in respect of sale have been duly sanctioned by appropriate authorities.

(iv) Where part of the sale price is intended to reimburse taxes or expenses, suitable provisions should be maintained for the purpose.

(v) The prices obtained for various plots of land sold should be checked with the plan map of the entire tract and any discrepancy or unreasonable price variations should be inquired into. The sale price of different plots of land should be verified on a reference to certified copies of sale deeds executed.

(vi) Out of the sale proceeds, provision should be made for the expenditure incurred on improvement of land, which so far has been accounted for.

**Q12. List out the steps to be taken by auditor while vouching/ verifying the 'Refund of General Insurance premium paid'. (RTP May21)**

Ans. Refund of General Insurance Premium paid: The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds:

(i) Ascertain the reasons for refund of insurance premium.

(ii) Examine insurance policy or cover note to find out the amount of premium.

(iii) Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.

(iv) Scrutinise correspondence between the insurance company and the client.

(v) Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.

**Q13. Newton Ltd. has made loans and advances on the basis of following securities to various borrowers. As an auditor what type of documents can be verified to ensure that the company holds a legally enforceable security?**

**(i) Shares and Debentures**

**(ii) Life Insurance Policy**

**(iii)Hypothecation of goods. (RTP May21)**

Ans. Documents to be seen in case of Securities:

**(iii)** Types of Security Documents etc. to be seen

**(iv)** (i) Shares and debentures The scrip and the endorsement thereon of the

**(v)** name of the transferee, in the case of transfer.

**(vi)** (ii) Life Insurance Policy. Assignment of policy in favour of the lender, duly

**(vii)** registered with the insurer

**(viii)** (iii) Hypothecation of goods Deed of hypothecation or other document creating

**(ix)** the charge, together with a statement of inventories

**(x)** held at the Balance Sheet date

# Chapter 10: The Company Audit

**Q1. Care Ltd. is an unlisted public limited company, During the financial year 2019-20, the paid-up share capital of Care Ltd. was INR 50 crore and the turnover was INR 80 crore. During the financial year 2020-21, the Board of Directors of the company appointed an internal auditor. Whether Care Ltd. is required to appoint an internal auditor according to the provisions of the Companies act, 2013? (July 21 Attempt)**

Ans. **As per section 138 of the Companies Act, 2013**: following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely-

(a) every listed company;

(b) every unlisted public company having-

(i) paid up share capital of fifty crore rupees or more during the preceding financial year; or

(ii) turnover of two hundred crore rupees or more during the preceding financial year; or

(iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or

(iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year.

**Conclusion:** Applying the above to the given problem, since Care Ltd is an unlisted public company and having paid up share capital of ` 50 crores during the preceding F.Y. 2019-20, therefore, Care Ltd is required to appoint an Internal Auditor.

**Q2. Shine Industries is an electricity generating company engaged in generation of electricity for captive consumption. Its gross turnover was INR 68 crores during the immediately preceding financial year.**

**Management of shine industries has not maintained any cost records as they felt that there is no requirement for them· to maintain any cost records or conduct any cost audit. Comment.(July 21 Attempt)**

Ans. **Applicability for Maintenance of Cost Records:** Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ` 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006. The said rule has divided the list of companies into (A) Regulated sectors and (B) Non-regulated sectors.

**Cost Audit Rules Not to Apply in Certain Cases:** The requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

(i) whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue

or

(ii) which is operating from a special economic zone.

(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant.

**Conclusion:** Since Shine Industries is having an overall turnover of ` exceeding 35 crore during the immediately preceding financial year, therefore, it is required to include cos records in its books of account but is not required to get its accounts audited because Cost Audit Rules are not applicable on Companies engaged in generation of electricity for captive consumption.

**Q3. The recommendation for appointment of auditors is only one of the several**

**functions performed by audit committee. Discuss atleast four other key responsibilities of Audit Committee in accordance with Section 177 of the Companies Act, 2013. (July 21 Attempt)**

Ans. Audit committee performs wide functions. The recommendation for appointment of auditors is only one of the several functions performed by audit committee. Under section 177 of Companies Act, 2013, audit committee is responsible for following actions :-

(i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;

(iii) examination of the financial statement and the auditors' report thereon;

(iv) approval or any subsequent modification of transactions of the company with related parties;

(v) scrutiny of inter-corporate loans and investments;

(vi) valuation of undertakings or assets of the company, wherever it is necessary;

(vii) evaluation of internal financial controls and risk management systems;

(viii) monitoring the end use of funds raised through public offers and related matters.

Hence, audit committee oversees range of matters including those related to making recommendation for appointment of auditors.

**Q4. Sec. 52 of the Companies Act states that Security Premium Account can be applied by the Company for one of the purpose mentioned below. Which of the following is a CORRECT option? (MTP)**

**(a) To adjust loss on revaluation of Assets**

**(b) To pay dividend to equity shareholders**

**(c) Providing for the premium payable on redemption of Preference shares**

**(d) To use it as working capital for its business.**

Ans. (c)

**Q5. Examine with reasons (in short) whether the following statements are correct or incorrect : (MTP)**

**CA K has resigned as an auditor after 2 months of his appointment in NML Ltd. He needs to file ADT-4 with the Registrar within 60 days from the date of resignation.**

Ans. **Incorrect:** As per section140(2) of the Companies Act, 2013, the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT–3(as per Rule 8 of CAAR) with the company and the Registrar.

**K Ltd., a non-government company, was incorporated on 01-10-2019. Mr. B, Managing Director of K Ltd., himself appointed the first auditor of the company on 31-12-2019.**

Ans. **Incorrect:** Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. In view of the above, the appointment of first auditor made by the managing director is in violation of the provisions of the Companies Act, 2013

**Q6. Provisions regarding appointment of Auditors-**

**(i) First auditor of a Government Company and a Non-Government Company.**

**(ii) Subsequent auditor of a Government Company and a Non-Government Company.(MTP)**

Ans. **(i) Appointment of First Auditor of a Government Company:** Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and part ly by one or more State Governments, 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.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

**Appointment of First Auditor of a Non-Government Company:** As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

**(ii) Appointment of Subsequent Auditor of a Government Company:** As per Section 139(5) of the Companies Act, 2013, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

**Appointment of Subsequent Auditor of a Non-Government Company:** As per section 139(1) of the Companies Act, 2013, every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

**Q7. As per Section 138 of the Companies Act, 2013 only listed companies are required to appoint an internal auditor. (MTP)**

Ans. **Applicability of Provisions of Internal Audit:** As per section 138 of the Companies Act, 2013 the following class of companies (prescribed in rule 13 of Companies(Accounts) Rules,2014) shall be required to appoint an internal auditor (which may be either an individual or a partnership firm or a body corporate), namely-

(1) every listed company;

(2) every unlisted public company having-

(i) paid up share capital of fifty crore rupees or more during the preceding financial year; or

(ii) turnover of two hundred crore rupees or more during the preceding financial year; or

(iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or

(iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

(3) every private company having-

(i) turnover of two hundred crore rupees or more during the preceding financial year; or

(ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In view of above, it would not be correct to state that only Listed Companies are required to appoint an internal auditor.

**Q8. "The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long term loans and advances." Advise**

**the auditor regarding reporting requirements under CARO, 2016. (MTP)**

Ans. **The auditor is required to report as per clause xiv of paragraph 3 of CARO 2016,** whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

In view of the above clause, the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose rather the company has utilised these funds for repayment of long term loans and advance.

**Q9. Enumerate the circumstances under which the retiring auditor can be re-appointed. (MTP 2)**

Ans. **Re-appointment of auditor:** A retiring auditor may be re-appointed at an annual general meeting, if-

(i) he is not disqualified for re-appointment.

(ii) he has not given the company a notice in writing of his unwillingness to be re-appointed; and

(iii) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.

(iv) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

**Q10. State the matters to be included in auditor's report as per CARO, 2016 regarding:**

**(i) Default in repayment of loan or borrowing to a financial institution, bank etc**

**(ii) Fraud by the company or on the company by its officers or employees. (MTP 2)**

Ans. **Matters to be included in Auditor's report as per CARO 2016:**

(i) Clause (viii) of Para 3 of CARO, 2016, requires the auditor to report whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

(ii) Clause (x) of Para 3 of CARO, 2016, requires the auditor to report whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

**Q11. (MTP 2) Mars Ltd. is a public limited Company incorporated during the previous financial year 2019-20. R S Shah & Associates have been appointed as the Auditors of the Company.**

**Para 1**

**Its Authorized Capital was Rs. 75 Lacs. Subsequently it increased its Share Capital. They issued Shares at a premium of Rs.25/- per share. The Company has transferred the amount received as premium to the Securities Premium Account.**

**Para 2**

**CA R recommended his Engagement Team to prepare an Audit Strategy as well as Audit plan for efficient conduct of audit. He advised to the team that they should include a series of verification procedures to be applied to Financial Statements of the Company for accomplishing the Audit objectives. CA R illustrated to his team the relationship between Audit strategy as well as Audit plan.**

**Para 3**

**Encompassed by a huge clientele, one of the Auditee firm was a LLP. It was in the name of Mangaldeep Geotech LLP. They conducted the business in a very efficient way but had allotted only the Audit and the Income Tax work to CA R S Shah & Associates. The Partners of the LLP were capable enough but however inadvertently**

**bypassed the ROC Compliances. They had no knowledge about the Compliances and its related penalties. Thus they approached CA R S Shah and Associates for their guidance. They were completely clueless as to filing of Annual Return with ROC.**

**Para 4**

**R S Shah and Associates have been appointed as Auditors of a large Enterprise namely Search Results Ltd. Considering the overhaul required in the Organization's Risk Management, Directors of the listed companies braced the subject of Internal Financial Control with much seriousness and rigor. The dawn of the Financial Year lays down the daunting task of establishing and implementing Internal Financial Control in an Enterprise.**

**Para 5**

**The Auditors are performing their Audit work in the Company Search Results Ltd by using CAAT's. The Company is completely automated and all the processes, operations are carried out using the Computer systems. Testing is performed in an automated environment to increase the efficiency and allow for more robust tools to be built. There are four types of testing methods in an Automated environment. They are Inquiry, Observation, Inspection and Re-performance.**

**Q. Sec. 52 of the Companies Act states that Security Premium Account can be applied by the Company for one of the purpose mentioned below. Which of the following is an INCORRECT option?**

**(a) To write off preliminary expenses of the Company**

**(b) To pay dividend to equity shareholders**

**(c) To provide premium on redemption of Preference share capital**

**(d) To purchase its own shares or other securities under Sec 68(Buyback)**

Ans. (b)

**Q12. (MTP 2) A Partnership Firm of Chartered Accountants by the name of S K and**

**Associates were appointed as the Auditors of the Company named Big Box Ltd.**

**Para 1**

**Big Box Ltd is a Public Listed Company. The CA Firm comprised of 2 partners namely CA S and CA K. Subsequently, a close relative of CA K, acquired security having face value Rs.495000/- of Big Box Ltd. As per the provisions of Section 141 of the Companies Act 2013, an Auditor will be disqualified from appointment, if the Auditor himself or his relative acquires the security exceeding the prescribed limit in the Company.**

**Para 2**

**Further, the Auditors, S K and Associates also had to bank on the policies and procedures adopted by the Company for ensuring the efficient conduct of its business. They have to state about the adequacy of Internal Financial Controls in the Company. The Company had a turnover of Rs. 60 Crores as per the latest Audited Balance Sheet and its Borrowings during the year were Rs. 20 Crores from Banks.**

**Para 3**

**The CFO of the Company, Mrs. Darshana felt dubious in the Accounts department of the Company. She entreated the Auditors to perform a thorough investigation of the Accounts department. Mrs. Darshana was also anticipating a fraud in this situation. Both the Auditor as well as the CFO of the Company analyzed the various risk factors. The Auditors observed that the Head Accountant of the Department has inflated the Sales amount to finish his targets. There was collusion between the Head Accountant & Employees of the Company. Employees were presented incentives on accomplishing their targets. This resulted in a fraud by the Head Accountant of amount aggregating to Rs.75 Lacs.**

**Para 4**

**Mr. X, an acquaintance of CA S, wanted to form an LLP with his distant relatives. He**

**wanted to possess in- depth knowledge about LLP. CA S explained him that LLP is a separate legal structure and is liable to full extent of its assets but the partners are liable to the extent of their agreed contribution in LLP. Mr. X additionally wanted to know the criteria for the accounts of LLP to be audited. CA S enlightened him that the accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.**

**Para 5**

**Big Box Ltd. is expanding its business. Consequently it requires many Computers. Purchasing computers may involve paying a huge upfront cost. Cash flow may get disrupted. Hence the Company came up with an idea of getting the Computers on lease. It will allow the businesses to have access to the latest technology without harming their cash flow. The Auditors explained to the Directors that leasing Computers shall come under the purview of Operating Lease.**

**Q. With reference to para 1, S K and Associates can take corrective actions within _______days. The relative may hold security or interest in the company of face value not exceeding ____________**

**(a) 45 days, Face Value Rs.100000/-**

**(b) 60 days, Market Value Rs.500000/-**

**(c) 30 days, Face Value Rs. 500000/-**

**(d) 60 days, Face Value Rs.100000/-**

Ans. (d)

**Q13 Under the provisions of Section 141(3) of Companies Act, 2013 along with relevant rules, a person or a firm who has “business relationship” with a company is not eligible to be appointed as an auditor of that company. In this context, discuss meaning of term “business relationship”. (RTP Nov21)**

AnsUnder provisions of section 141(3) of Companies Act, 2013, a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed is not eligible to be appointed as auditor of the company.

The term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except –

(i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;(ii) commercial transactions which are in the ordinary course of business of the company at arm’s length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

**Q14. Discuss significance of a company auditor’s right/power to obtain information and explanation from officers of the company. (RTP Nov21**)

Ans. The right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him.

Therefore, such a right/power is quite significant for discharge of duty of an auditor of a company to report to the members of the company on accounts examined by him.

**Q15.. Explain the Reporting requirements the auditor should ensure under CARO 2016 related to fixed assets. (RTP Nov 21)**

Ans. Reporting for Fixed Assets- Clause (i) of Para 3 of CARO ,2016, requires the auditor to include a statement in the auditor's report on the following matters, namely -

(i) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(ii) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(iii) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

**Q16. During the audit of PQR Ltd. you as an auditor requested officers of the company to have access to secretarial records and correspondence which they refused to provide. Comment. (RTP May21)**

Ans. Right of Access to secretarial records and correspondence:

1. Section 143(1) of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books of account and vouchers of the company kept at Registered or Head Office, branches and subsidiaries in the case of a Holding Company for conducting the audit.

2. Further, he is also entitled to require from the officers of the company such information and explanations which he considers necessary for the proper performance of his duties as Auditor. Therefore, he has a statutory right to inspect the secretarial records and correspondence.

3. In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company. It is, therefore, essential for the auditor to refer to the secretarial records and correspondence which also includes Minute book. In the absence of the same, the auditor may not be able to vouch/verify certain transactions of the company.

4. The refusal to provide access to secretarial records and correspondence shall constitute limitation of scope as far as the auditor's duties are concerned.

5. The auditor may examine whether by performing alternative procedures, the auditor can substantiate the assertions or else he shall have to either qualify the report or give a disclaimer of opinion.

**Q17. In exercise of the powers conferred by the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the "specified number of audit assignments of the companies under Section 141(3)(g) of the Companies Act, 2013).**

**Explain the provisions prescribed under Companies Act, 2013 in respect of ceiling on number of audits in a company to be accepted by an auditor. (RTP May21)**

Ans. Ceiling on number of Audits:

1. Before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding

of company audit by the auditor concerned over the limit laid down in section 141(3)(g) of the Companies Act, 2013 which prescribes that a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ` 100 crore, shall not be eligible for appointment as an Auditor of a Company.

2. In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere. This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits.

3. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

**Q18. Discuss the Provisions regarding appointment of Auditors -**

**(i) First auditor of a Government company and a Non-Government company.**

**(ii) Subsequent auditor of a Government company and a Non- Government company.**

**(RTP May21)**

Ans. (i) Appointment of First Auditor of a Government Company: Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, 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.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting.

Auditors shall hold office till the conclusion of the first annual general meeting.

Appointment of First Auditor of a Non-Government Company: As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

(ii) Appointment of Subsequent Auditor of a Government Company: As per Section 139(5) of the Companies Act, 2013, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

Appointment of Subsequent Auditor of a Non-Government Company: As per section 139(1) of the Companies Act, 2013, every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

# Chapter 11 - Audit Report

**Q1. State with reason whether the statement is correct or incorrect.**

**"The Location of the description of the auditor's responsibilities for the audit of the financial statements is always within the body of auditor's report". (July 21 Attempt)**

Ans. **Incorrect:** The description of the auditor's responsibilities for the audit of the financial statement shall be always shown as below:

- Within the body of the auditor's report
- Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix or

  By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

**Q2. CA Guru is in the process of preparing the final audit report of JPA Private Limited and would like to disclaim his opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence. How CA Guru shall amend the description of the auditor's responsibilities as required by SA 700 (Revised)? (July 21 Attempt)**

Ans. Since the auditor, CA Guru, disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence of JPA Pvt Ltd, the auditor (CA Guru) shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

(a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;

(b) A statement that, however, because of the matter(s) described in the Basis for

Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriateaudit evidence to provide a basis for an audit opinion on the financial statements ,

and

(c)The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised)

**Q3. "An auditor is required to make specific evaluations while forming an opinion in audit report". State those specific evaluations. (MTP)**

Ans. **Specific Evaluations by the auditor:** The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. In particular, the auditor shall evaluate whether :

(i) The financial statements adequately disclose the significant accounting policies selected and applied;

(ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

(iii) The accounting estimates made by management are reasonable;

(iv) The information presented in the financial statements is relevant, reliable, comparable, and understandable;

(v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and

(vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

**Q4. As an auditor of listed company, what are the matters that the auditor should keep in mind while determining "key Audit Matters". (MTP)**

Ans**. Determining Key Audit Matters:** As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

(i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.

(ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.

(iii) The effect on the audit of significant events or transactions that occurred during the period. The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

**Q5. Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. (MTP 2)**

Ans. **Examples of circumstances to include Emphasis of Matter Paragraph:**

As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are;

(a) An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.

(b) A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.

(c) Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.

(d) A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

**Q6. As an auditor of listed company, what are the matters that the auditor should keep in mind while determining "Key Audit Matters". (RTP Nov21)**

Ans. Determining Key Audit Matters: As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

(i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.

(ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.

(iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

**Q7. Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2020-21 the company transferred its accounts to computerised system (SAP) from manual system of accounts. Since the employees of the company were not well versed with the SAP system, there were many errors in the accounting during the transition period. As such the statutory auditors of the company were not able to extract correct**

**data and reports from the system. Such data was not available manually also. Further,**

**the employees and the management of the company were not supportive in providing the requisite information to the audit team. The auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.**

**Explain the kind of audit report that the statutory auditor of the company should issue in this case. (RTP Nov21)**

Ans. 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.

In the present case Delightful Ltd, the statutory auditor of the company is unable to extract correct data and reports from the SAP system for conduct of audit. Also, such data and reports are not available manually. Moreover, the auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

As such, the statutory auditor of Delightful Ltd. should give a disclaimer of opinion.

**Q8. The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. Discuss the type of opinionthat can be given and state giving reasoning. (RTP May21)**

Ans. Unqualified Opinion:

1. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.
2. An unqualified opinion indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.
3. An unqualified opinion also indicates that:
(i) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;
(ii) the financial statements comply with relevant statutory requirements and regulations; and
(iii) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

**Q9. The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally. Explain (RTP May21)**

Ans. The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users. This SA promotes consistency in the auditor's report but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions. Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user’s understanding and to identify unusual circumstances when they occur.

# Chapter12 : Bank Audit

**Q1. N Ltd. has been sanctioned a Cash Credit Facility by XYZ Bank Ltd. for INR 1 crore and drawing power as per the stock statements furnished for the last quarter is INR 80 Lakh. Outstanding balance in the account is INR 75 lakh. Interest charged to the account is INR 3.5 Lakh and total credit into the account for the quarter is INR 2.5 Lakh. As an auditor how will you report this account in your report. (July 21 Attempt)**

Ans. **Out of Order:** An account should be treated as 'out of order' if:

➢ the outstanding balance remains continuously in excess of the sanctioned

limit/drawing power or

➢ In cases where the outstanding balance in the principal operating account is less than

the sanctioned limit/drawing power, but there are no credits continuously for 90 days

as on the date of Balance Sheet; or

➢ Credits are there but are not enough to cover the interest debited during the same

period, these accounts should be treated as 'out of order'.

Applying the above to the given case of N Ltd, its Drawing power is ` 80 Lakhs, although outstanding balance in the account is ` 75 Lakhs, but still the account would be reported as out of order because credits in the account are not sufficient to cover the interest debited during the same period.

**Q2. Discuss the advantages of engagement team discussion done at the planning stage of the bank audit. (July 21 Attempt)**

Ans. **Advantages of engagement team discussion done at the planning stage of Bank audit are:**

 Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.

 It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.

 Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

**Q3. In case of a Bank, explain the meaning of Funded loans. Also give examples. (MTP)**

Ans, **Funded** loans are those loans where there is an actual transfer of funds from the bank to the borrower.

**Advances comprise of funded amounts by way of:**

• Term loans :-

• Cash credits, Overdrafts, Demand Loans

• Bills Discounted and Purchased

• Participation on Risk Sharing basis

• Interest-bearing Staff Loans

**Q4. ''There is no difference in provisioning of NPA as regards to categories of NPA, whether the debt is secured or unsecured." Critically evaluate the statement on the basis of provisioning norms of NPA of nationalised bank stating clearly the provision percent required. (MTP)**

Ans. **Classification as NPA** should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets which are given below:

| Categories of Non-Performing Assets | Provision Required |
|---|---|
| □ **Substandard Assets:** Would be one, which has remained NPA for a period less than or equal to 12 months. | **15%** |
| □ **Doubtful Assets:** Would be one, which has remained in the substandard category for a period of 12 months. | **Secured+Unsecured** |
| □ **Sub-categories:** Doubtful up to 1 Year (D1) | **25%+100%** |
| Doubtful 1 to 3 Years (D2) | **40%+100%** |
| Doubtful more than 3 Years (D3) | **100%+100%** |
| □ **Loss Assets:** Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. | |

**Q5. Explain "Advances under Consortium" in the context of Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances. (MTP 2)**

Ans. **Advances under Consortium:** Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

**Q6.The engagement team discussion ordinarily includes a discussion of the matters such as - Errors that may be more likely to occur; Errors which have been identified in prior years; Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures; etc.In the above context, explain the advantages of such a discussion. (RTP NOV21)**

Ans. Advantages of such a discussion :-

- Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
- Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

**Q7. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense. (RTP Nov21)**

Ans. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.

The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences.

The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger. The auditor should understand the process of computation of the average balance and re-compute the same on sample basis.

The auditor should, on a test check basis, verify the calculation of interest and ensure that:

(a) Interest has been provided on all deposits upto the date of the balance sheet;

(b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;

(c) Interest on savings accounts are in accordance with the rules framed by the bank/RBI in this behalf.

(d) Interest on inter–branch balances has been provided at the rates prescribed by the head office/RBI.

The auditor should ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period. The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly.

The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers. The auditor should re-compute the interest accrual i.e., by referring to the parameters like frequency of payment of interest amount, rate of interest, period elapsed till the date of balance sheet, etc. from the term sheet, deal ticket, agreements, etc. and ensure that the recomputed amount is tallying with the amount as per books of accounts without any significant difference.

**Q8. Your firm of auditors, SRG & Co., has been appointed as Statutory Central Auditors of Reliable Bank. Explain the reporting requirements of the Statutory Central Auditors (SCAs) in addition to their main audit report.(RTP May21)**

Ans. Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

(a) Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.

(b) Long Form Audit Report. (LFAR)

(c) Report on compliance with SLR requirements.

(d) Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.

(e) Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.

(f) Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.

(g) Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.

(h) Report on instances of adverse credit-deposit ratio in the rural areas.

**Q9. Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. Explain the broad considerations about which the auditor is primarily concerned with obtaining evidence in carrying out audit of advances. (RTP May21)**

Ans. Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

(a) Amounts included in balance sheet in respect of advances which are outs tanding at the date of the balance sheet.

(b) Advances represent amount due to the bank.

(c) Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.

(d) There are no unrecorded advances.

(e) The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.

(f) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.

(g) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

**Q10. While doing audit of ABC Pvt Ltd, on the basis of sufficient and appropriate evidence, auditor comes to a conclusion that use of the Going Concern Basis of Accounting is appropriate, but a material uncertainty exists. Discuss the implications for auditor's report if:**

**(a) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements**

**(b) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements (RTP nov21)**

Ans. Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists

The identification of a material uncertainty is a matter that is important to users' Understanding of the financial statements. The use of a separate section with a heading That includes reference to the fact that a material uncertainty related to going concern exists Alerts users to this circumstance.

(a) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements

If adequate disclosure about the material uncertainty is made in the financial Statements, the auditor shall express an unmodified opinion and the auditor's report Shall include a separate section under the heading "Material Uncertainty Related to Going Concern."

(b) Adequate Disclosure of a Material Uncertainty is Not Made in the FinancialStatementsIf adequate disclosure about the material uncertainty is not made in the financial Statements, the auditor shall:

(a) Express a qualified opinion or adverse opinion, as appropriate, in accordance With SA 705 (Revised); and

(b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state That a material uncertainty exists that may cast significant doubt on the entity's Ability to continue as a going concern and that the financial statements do not Adequately isclose this matter.

# Chapter 13 : Audit of Different Types of Entities

**Q1. State with reasons whether the following statement is correct or incorrect.**

**"The first auditor of a Multi-State co-operative Society will be appointed in Annual General Meeting". (July 21 Attempt)**

Ans. **Incorrect:** Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State Co-Operative Society in the general meeting may appoint the first auditor or auditors.

**Q2. Define Government Audit and explain its objectives. (July 21 Attempt)**

Ans. Government auditing is

- the objective, systematic, professional and independent examination
- of financial, administrative and other operations
- of a public entity
- made subsequently to their execution
- for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions
- by the responsible officials
- and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

**OBJECTIVES of Govt Audit are:**

**(a) Accounting for Public Funds:** Government audit serves as a mechanism or process for public accounting of government funds.

**(b) Appraisal of Government policies:** It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.

**(c) Base for Corrective actions:** Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.

**(d) Administrative Accountability:** The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration.

**Q3. You have been appointed as an auditor of VJM Schools. Discuss the points which merit your consideration as an auditor while verifying Assets and Liabilities of VJM Schools. (July 21 Attempt)**

Ans. **Verification of Assets & Liabilities of VJM Schools:**

1. Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.

2. Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet and not transferred to revenue, unless they are not refundable.

3. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

4. Ascertain that the system ordering inspection on receipt and issue of provisions, food stuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.

5. Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test

checked.

**Q4. Tomo Construction Engineering LLP approached CA K to understand various returns to be maintained and filed by them. Guide/Discuss the various returns to be maintained and filed by them. (July 21 Attempt)**

Ans. **Returns to be maintained and filed by an LLP:**

 Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.

 Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months or the financial year to which the Statement of Account and Solvency relates.

**Q5. Examine with reason (in short) whether the following statement is correct or incorrect :**

**All Non-Governmental Organisations (NGOs) registered under the Companies Act, 2013 are allowed to maintain accounts either on accrual basis or cash basis.(MTP)**

Ans. **Incorrect:** NGOs registered under the Companies Act, 2013 must maintain their books of account under the accrual basis as required by the provisions of section 128 of the said Act. If the accounts are not maintained on accrual basis, it would amount to non-compliance of the provision of the Companies Act, 2013. The NGOs which are not registered under the Companies Act, 2013 are allowed to maintain accounts either an accrual basis or cash basis.

**Q6. You have been appointed auditor of Dr. Prem Ratan Hospital. Discuss any eight important points that would attract your attention while audit. (MTP)**

Ans. **AUDIT OF HOSPITAL**

The important points involved in such an audit are stated below-

(i) **Register of patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.

(ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For eg. copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills etc.

(iii) **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.

(iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.

(v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).

(vi**) Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.

(vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.

(viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.

(ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.

(x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.

(xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.

(xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.

(xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

**Q7. "Public moneys should not be utilized for the benefit of a particular person or section of the community". List out the exceptions to this rule while audit against propriety. (MTP)**

Ans. **Exceptions to the rule – Audit Against Propriety:** Public moneys should not be utilised for the benefit of a particular person or section of the community unless:

(i) the amount of expenditure involved is insignificant; or

(ii) a claim for the amount could be enforced in a Court of law; or

(iii) the expenditure is in pursuance of a recognised policy or custom; and

(iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

**Q8. What is the function of audit while examining various rules, regulations and orders with regard Audit against Rules & Orders by C&AG? (MTP 2)**

Ans. Audit against Rules & Orders – Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made there under. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

(a) they are not inconsistent with any provisions of the Constitution or any laws made there under;

(b) they are consistent with the essential requirements of audit and accounts as determined by the C&AG;

(c) they do not come in conflict with the orders of, or rules made by, any higher authority; and

(d)in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

**Q9. (i) List out the types of Revenue Grants received by local bodies from the State.**

**(ii) PQR Ltd., a government company, constructed a building in conformity with rules and regulations for installing a telephone exchange but not used for the same purpose resulting in the infructuous expenditure.**

**Considering the above case, explain the type of expenditure audit to be performed to curb the situation. (MTP 2)**

Ans. **(i) Revenue grants received by Local Bodies:**

Local bodies may receive different types of grants from the state administration. Broadly the revenue grants are of three types:

(1) General purpose grants: These are primarily intended to substantially bridge the gapbetween the needs and resources of the local bodies.

(2) Specific purpose grants: These grants which are tied to the provision of certain services or performance of certain tasks.

(3) Statutory and compensatory grants: These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

**(ii) Propriety audit:** According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Further, it may so happen that a transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned but may still be highly wasteful.

In the given situation, PQR Ltd. being a government company, constructed a building in conformity with rules and regulations for installing a telephone exchange but not used for the same purpose resulting in an infructuous expenditure.

Thus, propriety audit should be done for PQR Ltd. to bring out improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations to the notice of the proper authorities of wastefulness in public administration.

**Q10. The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 provides certain powers to the C & AG in connection with performance of his duties. Discuss. (MTP 2)**

Ans. Powers of C & AG in performance of his duties: The Comptroller and Auditor General's (Duties, Powers and Condition of Service) Act, 1971 gives the following powers to the C&AG in connection with the performance of his duties:

(i) To inspect any an office accounts under the control of the union or a State Government including office responsible for creation of initial or subsidiary accounts.

(ii) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.

(iii) To put such questions or make such observations as he may consider necessary to the person- in charge of the office and to call for such information as he may require for preparation of any account or report, which is his duty to prepare.

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transaction as he may determine.

**Q11. (MTP 2) Mars Ltd. is a public limited Company incorporated during the previous financial year 2019-20. R S Shah & Associates have been appointed as the Auditors of the Company.**

**Para 1**

**Its Authorized Capital was Rs. 75 Lacs. Subsequently it increased its Share Capital. They issued Shares at a premium of Rs.25/- per share. The Company has transferred the amount received as premium to the Securities Premium Account.**

**Para 2**

**CA R recommended his Engagement Team to prepare an Audit Strategy as well as Audit plan for efficient conduct of audit. He advised to the team that they should include a series of verification procedures to be applied to Financial Statements of the Company for accomplishing the Audit objectives. CA R illustrated to his team the relationship between Audit strategy as well as Audit plan.**

**Para 3**

**Encompassed by a huge clientele, one of the Auditee firm was a LLP. It was in the name of Mangaldeep Geotech LLP. They conducted the business in a very efficient way but had allotted only the Audit and the Income Tax work to CA R S Shah & Associates. The Partners of the LLP were capable enough but however inadvertently bypassed the ROC Compliances. They had no knowledge about the Compliances and**

**its related penalties. Thus they approached CA R S Shah and Associates for their guidance. They were completely clueless as to filing of Annual Return with ROC.**

**Para 4**

**R S Shah and Associates have been appointed as Auditors of a large Enterprise namely Search Results Ltd. Considering the overhaul required in the Organization's Risk Management, Directors of the listed companies braced the subject of Internal Financial Control with much seriousness and rigor. The dawn of the Financial Year lays down the daunting task of establishing and implementing Internal Financial Control in an Enterprise.**

**Para 5**

**The Auditors are performing their Audit work in the Company Search Results Ltd by using CAAT's. The Company is completely automated and all the processes, operations are carried out using the Computer systems. Testing is performed in an automated environment to increase the efficiency and allow for more robust tools to be built. There are four types of testing methods in an Automated environment. They are Inquiry, Observation, Inspection and Re-performance.**

**Q. In reference to para 3, which form from the following should be filed by the Partners to avoid penalty consequences?**

**(a) Form 11 within 90 day of end of closer of financial year and Form 8 within a period of 60 days from the end of six months of the financial year.**

**(b) Form 11 within 60 days of end of closer of financial year and Form 8 within a period of 30 days from the end of six months of the financial year.**

**(c) Form 11 within 30 days of end of closer of financial year and Form 8 within a period of 60 days from the end of three months of the financial year.**

**(d) Form 11 within 60 day of end of closer of financial year and Form 8 within a period of 90 days from the end of three months of the financial year.**

Ans. (b)

**Q12. (MTP 2) A Partnership Firm of Chartered Accountants by the name of S K and Associates were appointed as the Auditors of the Company named Big Box Ltd.**

**Para 1**

**Big Box Ltd is a Public Listed Company. The CA Firm comprised of 2 partners namely CA S and CA K. Subsequently, a close relative of CA K, acquired security having face value Rs.495000/- of Big Box Ltd. As per the provisions of Section 141 of the Companies Act 2013, an Auditor will be disqualified from appointment, if the Auditor himself or his relative acquires the security exceeding the prescribed limit in the Company.**

**Para 2**

**Further, the Auditors, S K and Associates also had to bank on the policies and procedures adopted by the Company for ensuring the efficient conduct of its business. They have to state about the adequacy of Internal Financial Controls in the Company. The Company had a turnover of Rs. 60 Crores as per the latest Audited Balance Sheet and its Borrowings during the year were Rs. 20 Crores from Banks.**

**Para 3**

**The CFO of the Company, Mrs. Darshana felt dubious in the Accounts department of the Company. She entreated the Auditors to perform a thorough investigation of the Accounts department. Mrs. Darshana was also anticipating a fraud in this situation. Both the Auditor as well as the CFO of the Company analyzed the various risk factors. The Auditors observed that the Head Accountant of the Department has inflated the Sales amount to finish his targets. There was collusion between the Head Accountant & Employees of the Company. Employees were presented incentives on accomplishing their targets. This resulted in a fraud by the Head Accountant of amount aggregating to Rs.75 Lacs.**

**Para 4**

**Mr. X, an acquaintance of CA S, wanted to form an LLP with his distant relatives. He wanted to possess in- depth knowledge about LLP. CA S explained him that LLP is a separate legal structure and is liable to full extent of its assets but the partners are liable to the extent of their agreed contribution in LLP. Mr. X additionally wanted to know the criteria for the accounts of LLP to be audited. CA S enlightened him that the accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009.**

**Para 5**

**Big Box Ltd. is expanding its business. Consequently it requires many Computers. Purchasing computers may involve paying a huge upfront cost. Cash flow may get disrupted. Hence the Company came up with an idea of getting the Computers on lease. It will allow the businesses to have access to the latest technology without harming their cash flow. The Auditors explained to the Directors that leasing Computers shall come under the purview of Operating Lease.**

**Q. With regard to information provided in Para 4, which of the following is a CORRECT option?**

**(a) Any LLP whose turnover does not exceed, in any financial year, Rs.40 Lacs or whose contribution does not exceed Rs.25 Lacs is not required to gets its accounts audited.**

**(b) Any LLP whose turnover does not exceed, in any financial year, Rs.50 Lacs or whose contribution does not exceed Rs.20 Lacs is not required to gets its accounts audited.**

**(c) Any LLP whose turnover exceeds Rs.25 Lacs in any financial year or whose contribution exceeds Rs.10 Lacs in any financial year is required to gets its accounts audited.**

**(d) Any LLP whose turnover does not exceed, in any financial year, Rs.40 Lacs and**

**whose contribution does not exceed Rs.25 Lacs is not required to gets its accounts audited.**

Ans. (a)

**Q13. The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. Explain stating important objectives of audit of such bodies. (RTP Nov21)**

Ans. The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, 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:

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

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

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

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

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

**Q14. While planning the audit of an NGO, the auditor may focus on Knowledge of the NGO's work, its mission and vision, Updating knowledge of relevant statutes especially with regard to recent amendments, circulars etc. Explain the other relevant points the auditor needs to focus while planning the audit of NGO. (RTP Nov21)**

Ans. 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.

**Q15. Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession. Explain stating clearly the definition of Government auditing as discussed in U.N. Handbook on Govt Auditing and Developing Countries and also state Objectives of Govt audit.(RTP may21)**

Ans. Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession.

The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows:

Government auditing is

- the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity made subsequently to their execution for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actiotheby the responsible officials and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

OBJECTIVES :-

(a) Accounting for Public Funds:-Government audit serves as a mechanism or process for public accounting of government funds.

(b) Appraisal of Government policies:-It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.

(c) Base for Corrective actions:-Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.

**Q16. Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end. Explain (RTP May21)**

Ans. Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end. The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration. In India, the function of Government Audit is discharged by the independent statutory authority of the Comptroller and Auditor General through the agency of the Indian Audit and

Accounts Department. Audit is a necessary function to ensure accountability of the executive to Parliament, and within the executives of the spending agencies to the sanctioning or controlling authorities. The purpose or objectives of audit need to be tested at the touchstone of public accountability. The Comptroller and Auditor General (C&AG), in the discharge of his functions, watches that the various authorities act in regard to financial matters in accordance with the Constitution and the laws made by Parliament, and conform to the rules or orders made thereunder.