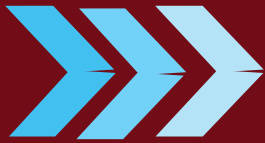


CA FINAL

ADVANCED AUDITING, ASSURANCE
& PROFESSIONAL ETHICS

NEW QUESTIONS



**RELEVANT FOR MAY 2024
EXAMS AND ONWARDS**

Compiled by : **CA PANKAJ GARG**

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Additional Questions

[Asked in RTP (Nov. 23), MTP (Sep. 23 & Oct. 23) and Past Exam (Nov. 23)]

PART I – DESCRIPTIVE QUESTIONS

Chapter 1 – Quality Control

1.1 – SQC 1 “Quality Control for Firms that perform Audits & Reviews of Historical Financial Information and Other Assurance and Related Services Engagements”

Q.8A CA Ragini is offered appointment to act as Engagement Quality Control Reviewer (EQCR) for the audit of financial year 2023-24 of XPM Limited, a listed company operating from a small town. She is also based in the same town and was not engaged previously to conduct audit of a listed entity. She accepts the appointment to act as EQCR. She performs the review by ticking a “Yes / No” checklist and signing on some of working papers prepared by engagement team. The audit file does not contain any material which shows that the work of EQCR is separate from the work of the engagement team. Do you agree with the approach adopted by EQCR? By commenting on issues involved in the above situation, discuss whether she can be held guilty of professional misconduct. [MTP-Sep. 23, Oct. 23]

Ans: Engagement Quality Control Review (EQCR):

- SQC 1 states that EQC reviewer is a partner, other person in firm (member of ICAI), a suitably qualified external person, or a team made up of such individuals with sufficient and appropriate experience and authority to evaluate objectively, before report is issued, significant judgments the engagement team made and the conclusions they reached in formulating the report.
- It also states that EQC reviewer for an audit of the F.S. of a listed entity is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.
- In addition, work of EQC Reviewer involves objective evaluation of the significant judgments made by engagement team and ensuring that the conclusions reached by the team in formulating audit reports are appropriate. It is necessary for EQC Reviewer to have requisite technical expertise and experience to enable her to perform the assigned role of evaluating the work of the engagement team so that any possible misstatement can be avoided. Without ensuring the appropriate technical expertise and experience, the whole purpose of EQCR is defeated. Therefore, it was not appropriate for her to accept an appointment as ECQ Reviewer for the listed entity.
- Further, SA 220 states that EQC reviewer shall document, for the audit engagement reviewed, that the procedures required by the firm’s policies on engagement quality control review have been performed. It also states that it shall also be documented that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.
- In the given situation, there are no working papers to show that EQCR has done an evaluation on conclusions reached by the engagement team. Mere ticking of a Yes/No checklist and signing on some working papers of the engagement team shows that EQCR has made no such evaluation and review of work performed by the engagement team.

Conclusion: Approach of CA Ragini was not proper in performing the work of EQC Reviewer.

Professional Misconduct:

- CA Ragini has allowed the issuance of an audit report of the company without carrying out due procedures as discussed above; hence she is guilty of professional misconduct under clauses 8 & 9 of Part I of the Second Schedule to Chartered Accountants Act, 1949.
- Under Clause 8, a CA is held guilty of professional misconduct in case of failure to obtain sufficient information which is necessary for the expression of an opinion, or its exceptions are sufficiently material to negate the expression of an opinion.
- Clause 9 is applicable in case of failure to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

Conclusion: CA Ragini is guilty of professional misconduct, as discussed above.

1.2 - SA 220 "Quality Control for an Audit of Financial Statements"

Q.12A SS Ltd. is a company listed in India. The Company has appointed M/s Z & Co. as auditors. Mr. Q a CA has recently joined the firm and has been appointed as the engagement partner for the first time. He understands that it is necessary to ensure the compliance of independence for the audit team as per standard audit practices. But he could not find as such, any policies and procedures available with the firm in documented form.

Why do you think that the firm should have policies and procedures to ensure the independence of the firm in every assignment? How does an engagement partner ensure the compliance of independence? Discuss with reference to relevant SAs. [Nov. 23 (5 Marks)]

Ans: Requirement of having policies and procedures to ensure independence of firm:

- SQC 1 "Quality Control for Firms that Perform Audits & Reviews of Historical Financial Information, and Other Assurance & Related Services Engagements" requires that firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code.
- Such policies and procedures should enable the firm to:
 - (a) Communicate its independence requirements to its personnel
 - (b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

Ensuring compliance of independence:

As per SA 220 "Quality control for an Audit of Financial Statements" the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

- (a) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
- (b) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- (c) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Chapter 3 – Audit Planning, Strategy & Execution

3.7 - SA 540 “Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures”

Q.33A Mr. Bal a CA has been appointed as the auditor of Healthy Foods Pvt. Ltd. The company purchases various types of grains and converts them into flour. While obtaining an understanding of the control environment of the company, he found that entity's risk assessment procedure has some loopholes at various points in the purchase process and company is required to make certain material assertions in financial statements on the basis of fair value estimation. CA Bal foresees a risk of material misstatement due to these fair value estimations. Suggest him as to how he should deal with such risks? Elucidate with reference to relevant SAs. [Nov. 23 (5 Marks)]

Ans: Dealing with Risks arises to Fair Value Estimations:

As per SA 540 “Auditing Accounting Estimates, including Fair Value Accounting Estimates” auditor shall obtain an understanding of the following in order to identify and assess the risks of material misstatement for accounting estimates:

- (a) The **requirements of the applicable FRF** relevant to accounting estimates.
- (b) **How management identifies** those transactions, events and conditions that may give rise to the need for accounting estimates.
In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing accounting estimates.
- (c) The **estimation making process** adopted by the management including:
 - (i) The method, including where applicable the model used in making the accounting estimates.
 - (ii) Relevant controls.
 - (iii) Whether management has used an expert.
 - (iv) Assumptions underlying the accounting estimates.
 - (v) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so why.
 - (vi) Whether and if so, how the management has assessed the effect of estimation uncertainty.
- (d) Auditor shall **review the outcome of accounting estimates** included in the prior period financial statements.

Note: Alternate Answer based on estimation uncertainties is also possible.

Chapter 4 – Materiality, Risk Assessment and Internal Control

4.4 – Components of Internal Control

Q.16A SA 315 requires the auditor to document key elements of understanding obtained regarding each of its internal control components, sources of information from which such understanding was obtained and risk assessment procedures performed.
While conducting statutory audit of MPT Limited, a listed company, CA Z has understood various IT controls relating to data centre and network operations, system software acquisition, change and maintenance, program change, access security and application system acquisition, development and maintenance operating in the company. Besides, he has also gained knowledge of application controls designed to ensure the integrity of accounting records.

Which one of the internal control components of the company is referred to in the above description? Besides activities gathered from the above description, give examples of any other two activities relevant for an audit included in the above identified “component of internal control” of the company. [MTP-Oct. 23]

Ans: Components of Internal Control:

CA Z has gained an understanding of various IT controls operating in the company including General IT controls and application controls. Such activities form part of “control activities”, which is one of the components of internal control of an organization.

Control activities are the policies and procedures that help ensure 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:

(a) Performance reviews

These control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance.

(b) Physical controls: Controls that encompass:

- The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.
- The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records).

4.8 – Miscellaneous Questions

Q.31A While conducting a statutory audit of “Hope Solutions Limited”, CA Y has assessed the risk of material misstatement to be low at the financial statement level and at the assertion level due to a stable, established and relatively less risky business and extremely satisfactory internal controls operating in the company. However, despite the low assessed risk of material misstatement, he chooses to send external confirmation requests to third parties for confirmation of certain material contracts entered into with them by the company. By doing so, he intends to obtain evidence regarding certain assertions contained in the financial statements of the company. Do you think his approach is in accordance with Standards on Auditing? Justify your answer with reasons.

[MTP-Oct. 23]

Ans: Designing and performing substantive procedures:

- SA 330 states that irrespective of the assessed risk of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure. In the given situation, the auditor has assessed the risk of material misstatement to be low. However, despite such assessment, substantive procedures have to be performed.
- SA 330 further states that the auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties.
- Despite the low assessed risk of material misstatement, substantive procedures have to be performed due to the following reasons: -

- (i) The auditor’s assessment of risk is judgmental and so may not identify all risks of material misstatement and
 - (ii) there are inherent limitations to internal control, including management override.
 - It is also in accordance with the spirit of professional skepticism.
- Conclusion:** Approach of CA Y is in accordance with Standards on Auditing.

Chapter 5 – Audit Evidence

5.1 - SA 500 “Audit Evidence”

Q.3A ABC Ltd. appointed Mr. Anand for the actuarial calculation of liabilities associated with insurance contracts and employee benefit plans. These calculations and valuations are then adopted by management in preparing the financial statements. Kindly guide Mr Sushil, the statutory auditor of ABC Ltd, on the use of information prepared by management’s appointed expert as audit evidence. Also, explain Mr. Sushil the matters that can impact the nature, timing and extent of audit procedures regarding information to be used as audit evidence which has been prepared using the work of a management’s expert. [MTP-Sep. 23]

Ans: Use of information prepared by management’s appointed expert as audit evidence

As per SA 500, “Audit Evidence”, when information to be used as audit evidence has been prepared using the work of a management 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.

Matters that can impact the nature, timing and extent of audit procedures:

Nature, timing and extent of audit procedures in relation to the requirement relating to information to be used as audit evidence prepared using the work of a management’s expert may be affected by such matters as:

- (1) The nature and complexity of the matter to which the management’s expert relates.
- (2) The risks of material misstatement in the matter.
- (3) The availability of alternative sources of audit evidence.
- (4) The nature, scope and objectives of the management’s expert’s work.
- (5) Whether the management’s expert is employed by the entity or is a party engaged by it to provide relevant services.
- (6) The extent to which management can exercise control or influence over the work of the management’s expert.
- (7) Whether the management’s expert is subject to technical performance standards or other professional or industry requirements.
- (8) The nature and extent of any controls within the entity over the management’s expert’s work.

Q.3B Mr. Shreyansh, while performing the audit of Red Rock & Silver Sand Limited which was involved in phosphorus mining, decided to appoint an auditor’s expert for the valuation of environmental liabilities and site clean clean-up costs. Red Rock & Silver Sand Limited re re-appointed Mr. Sheetal as an independent expert for this engagement. For the last five years, management has been re re-appointing Mr. Sheetal. Mr. Sheetal calculated the environmental liabilities pertaining to completed mining sites and the sites which will be discarded in the near future and a provision for clean clean-up costs. This provision was accepted by management.

Mr. Shreyansh, after performing the inquiries with management, was of the opinion that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. Hence, there is no need to raise a question on the objectivity of Mr. Sheetal or on his work performed for the company.

However, the audit partner was of the opinion that the audit team needs to evaluate the objectivity of an expert engaged by the entity, irrespective of the fact that he was appointed as an independent expert. Kindly guide the audit partner and Mr. Shreyansh with respect to requirements pertaining to evaluating the objectivity of the management expert. [RTP-Nov. 23]

Ans: Requirements pertaining to evaluating the objectivity of the management expert

- 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, have regard to the significance of that expert’s work for the auditor’s purposes evaluate the competence, capabilities and objectivity of that expert.
- A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the management’s expert’s profession, legislation or regulation), or by the management’s expert’s work environment (for example, quality control policies and procedures). Although safeguards cannot eliminate all threats to a management expert’s objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.
- When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert’s objectivity and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:
 - (a) Financial interests.
 - (b) Business and personal relationships.
 - (c) Provision of other services.
- In the current case, Red Rock & Silver Sand Limited re-appointed Mr. Sheetal for this engagement as an independent expert. The audit team was of the view that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. However, the audit partner had a contrary view.

Conclusion: Audit team should evaluate the objectivity of an expert engaged by the entity as the threat to objectivity, created by being an employee of the entity, will always be present. An expert appointed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity. As a result, audit partner is correct in his view.

5.3 – SA 505 “External Confirmations”

- Q.17A** Mr. Rishabh, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Rishabh, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures. [MTP-Sep. 23]

Ans: Factors that assist auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures

- (i) **The confirming party's knowledge of the subject matter** – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- (ii) **The ability or willingness of the intended confirming party to respond** – for example, the confirming party:
- May not accept responsibility for responding to a confirmation request;
 - May consider responding too costly or time consuming;
 - May have concerns about the potential legal liability resulting from responding;
 - May account for transactions in different currencies; or
 - May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- (iii) **The objectivity of the intended confirming party** – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

Chapter 6 – Completion and Review

6.2 – SA 570 “Going Concern”

- Q.14A** MZE Limited is engaged in the manufacturing and export of ready-made garments. The company has lost overseas buyers to Asian competitors with lower raw materials and labour costs. As a result, MZE Limited has lost out on a significant chunk of export orders, and the trend has become more pronounced in the year 2023-24. Further, the US economic recession caused delays in the company's overseas payments, leading to the company being unable to keep its loan repayment commitments with bankers. Further, the company has not been able to pay its creditors on time. Even statutory dues payable by the company are either not paid or being paid after a gap of 5-6 months, leading to extra costs. Due to declining revenue, the company cannot cover its fixed costs and has begun laying off employees.
- Considering all these circumstances, CA P doubts the company's ability to continue as a going concern while conducting the statutory audit for the year 2023-24. He is studying management's assessment of the company's ability to continue as a going concern by studying projected profitability statements for the next two years containing turnover, expenses and profits estimates. Comment on the above situation with specific reference to audit procedures being performed by CA P in context of relevant Standards on Auditing. [MTP-Oct. 23]

Ans: Evaluation of Appropriateness of Going Concern Basis of Accounting:

- The indicated events or conditions in MZE Limited may cast significant doubt on ability of company to continue as going concern. SA 570 requires that if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not 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 through performing additional audit procedures, including consideration of mitigating factors.

- In the given situation, the auditor is studying management's assessment of the company's ability to continue as going concern, including its future plan of action containing projected profitability statements for the next two years containing estimates of turnover, expenses and profits. However, as required in SA 570, auditor's procedures should focus on cash flow forecast and not on future profit projections. It is quite possible that a company may continue to carry on as a going concern so long as it can meet its liabilities. Therefore, analysing the projected profitability statements alone is insufficient to support the conclusion on the going concern assumption followed by the company.
- Therefore, the auditor should require management to prepare a cash flow forecast in the given circumstances. The auditor should then analyse the cash flow forecast in the evaluation of management's future plan of action. It includes: -
 - (a) Evaluating the reliability of the underlying data generated to prepare the forecast and
 - (b) Determining whether there is adequate support for the assumptions underlying the forecast
- Further, some major overseas payments of the company are stuck up. It is quite possible that the timing of cash inflows on account of these payments may affect the situation.

Conclusion: Auditor would have to evaluate the reliability of data for preparation for such a forecast and its underlying assumptions. He should perform procedures to obtain evidence regarding assumptions and timing of cash inflows and outflows like any restructuring undertaken by bankers providing relief to the company, future sales and consequent cash realization in downturn conditions, willingness of creditors to provide credit in such a situation, incurring of expenditures to keep the company afloat.

All these assumptions underlying such cash flow forecasts need to be challenged and examined.

Chapter 7 – Reporting

7.1 - SA 700 "Forming an Opinion and Reporting on Financial Statements"

- Q.5A** XYZ Limited involved in the hospitality business, appointed Charan & Karan Associates as their statutory auditor for FY 2023-24. Management of XYZ Limited, while drawing up the financial statement for the said period, decided to add the following statement after the Statement of Cash Flow as supplementary information to be presented with financial statements. No specific mentions or labels were added to this statement to present that this is supplementary information.

Statement of Average Revenue Per Booking (ARPB) and Comparative

(in ₹ or otherwise stated)	
Total Bookings during FY	
- FY 2022 - 23	36500
- FY 2023 - 24	39000
Average Revenue per Booking	
- FY 2022 - 23 (Refer Note 28 Revenue from Operations)	3500
- FY 2023 - 24 (Refer Note 28 Revenue from Operations)	4200
Bookings Ratio (Organic source by Inorganic source)	
- FY 2022 - 23	1:2
- FY 2023 - 24	1:1.65

Kindly guide the audit team regarding the requirement of SA 700 with respect to the Supplementary Information Presented with the Financial Statements. [RTP-Nov. 23]

Ans: Requirement of SA 700 with respect to Supplementary Information Presented with F.S.:

- As per SA 700 “Forming an Opinion and Reporting on Financial Statements”, if supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor’s professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor’s opinion.
- If supplementary information that is not required by the applicable FRF is not considered an integral part of audited F.S., auditor shall evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from audited F.S.. If this is not the case, then auditor shall ask management to change how unaudited supplementary information is presented. If management refuses to do so, auditor shall identify unaudited supplementary information and explain in auditor’s report that such supplementary information has not been audited.
- The auditor’s evaluation of whether unaudited supplementary information is presented in a manner that could be construed as being covered by the auditor’s opinion includes, for example, where that information is presented in relation to the financial statements and any audited supplementary information and whether it is clearly labelled as “unaudited.”
- In the current case, the Statement of Average Revenue Per Booking (ARPB) and Comparative is unaudited supplementary information that could be construed as being covered by the auditor’s opinion. Hence, the audit team should evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If not, then audit can suggest management to change the presentation of unaudited supplementary information by:
 - (a) Removing any cross cross-references from the financial statement s to unaudited supplementary schedules or unaudited notes so that the demarcation between the audited and unaudited information is sufficiently clear.
 - (b) Placing unaudited supplementary information outside of the F.S. or, if that is not possible in the circumstances, at a minimum placing the unaudited notes together at the end of the required notes to the financial statements and clearly labelling them as unaudited. Unaudited notes that are intermingled with audited notes can be misinterpreted as being audited.

Conclusion: If the management of XYZ Limited refuses to do so, the auditor shall identify the unaudited supplementary information, i.e., Statement of ARPB and Comparative and explain in the auditor’s report that such supplementary information has not been audited.

7.3 - SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”

- Q.30A** While conducting audit of RAC Limited, CA R has discovered a misstatement in the financial statements of a company due to non-write off of a huge trade receivable with an outstanding amount of ₹ 2 crores. The party in question has fled from India and is now absconding. After reviewing the audit evidence, it was concluded by the auditor that there is no possibility of recovering the outstanding debt. Despite the matter being brought to the attention of the management, they have refused to correct the misstatement. As a result, the financial statements of the company show a profit before tax of ₹ 1 crore, which is incorrect due to the management’s refusal to correct the aforementioned misstatement. Materiality has been determined for financial statements @ 5% of profit before tax. Comment as regards to type of opinion to be given by CA R in above situation on the basis of provided information. [MTP-Oct. 23]

Ans: Modified Opinion:

- SA 705 states that the auditor shall modify the opinion in the auditor’s report when:
 - (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
- In the given situation, auditor has obtained evidence in relation to non-recoverability of outstanding trade receivable.
- SA 705 further states that the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- In this scenario, the uncorrected misstatement stands at 200% of the profit before tax, while the materiality has been determined at 5% of the profit before tax. Hence, this misstatement should be considered as material. Additionally, if such a substantial amount is written off, it would significantly impact the financial position of the company. As a result, losses would have to be reported instead of profits. Taking the above factors into consideration, this misstatement should be classified as both material and pervasive.

Conclusion: Adverse opinion needs to be expressed in accordance with the requirements of SA 705.

7.4 - SA 706 “Emphasis of Matter Paragraph & Other Paragraphs in the Independent Auditor’s Report”

Q.38A How does the inclusion of Emphasis of Matter (EOM) paragraphs in the Auditor’s Report differ from the disclosure of Key Audit Matters (KAM)? [RTP-Nov. 23]

Ans: Emphasis of Matter (EOM) paragraphs in the Auditor’s Report vs. disclosure of Key Audit Matters (KAM):

Relationship between Emphasis of Matter Paragraphs and Key Audit Matters in the Auditor’s Report

Those matters that, in the auditor’s professional judgment, were of most significance in the audit of the F.S. of the current period. KAM are selected from matters communicated with TCWG. [SA 701]	A paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the F.S. that, in auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the F.S. [SA 706]
Matters that are determined to be KAM in accordance with SA 701 may also be, in auditor’s judgment, fundamental to users’ understanding of F.S. In such cases, in communicating matter as a KAM, auditor may wish to highlight or draw further attention to its relative importance. Communicating KAM provides additional information to intended users of the F.S. to assist them in understanding those matters that, in the auditor’s professional judgment, were of most significance in the audit and may also assist them in understanding the entity and areas of significant management judgment in audited F.S.	A widespread use of EOM paragraphs may diminish the effectiveness of auditor’s communication about such matters. Use of EOM paragraphs is not a substitute for a description of individual key audit matters where SA 701 is applicable. There may be a matter that is not determined to be a KAM in accordance with SA 701, but which, in the auditor’s judgment, is fundamental to users’ understanding of the F.S. (e.g., a subsequent event). If the auditor considers it necessary to draw users’ attention to such a matter, matter is included in an EOM paragraph in auditor’s report in accordance with this SA.

	<p>Communication of KAM in the auditor's report may also provide intended users a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited F.S., or the audit that was performed.</p>	<p>Auditor may do so by presenting the matter more prominently than other matters in the KAM section (e.g., as the first matter) or by including additional information in the description of the KAM to indicate the importance of the matter to users' understanding of the financial statements.</p>
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7.9 - Matters to be included in Auditor's Report under CARO, 2020

Q.63A ABC & Associates are conducting audit of consolidated financial statements of "Crazy Paints Limited" for year 2023-24. The consolidated financial statements consist of financial statements of parent company and its five subsidiaries (audited by component auditors). While drafting audit report in respect of consolidated financial statements under Companies Act, 2013, how firm should proceed to deal with issue of reporting under CARO, 2020? [MTP-Oct. 23]

Ans: Reporting under CARO, 2020:

- CARO, 2020 specifically provides that it shall not apply to the auditor's report on consolidated financial statements except clause (xxi) of paragraph 3. This means that the auditor will need to give a CARO report on the consolidated financial statements with respect to clause 3(xxi) of the Order only. Thus, the auditor is not required to report on rest of the clauses of paragraph 3.
- Clause 3(xxi) of CARO 2020 requires the auditor to state whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements. If yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.
- Therefore, it requires the auditor to provide details of the companies and the paragraph numbers of the respective CARO report containing the qualifications or adverse remarks only. Reporting under this is only required for those entities included in the consolidated financial statements to whom CARO 2020 is applicable.

Q.63B CA. F has been appointed as the Statutory Auditor of XYZ Limited for the financial year 2023-24. XYZ Limited has one subsidiary, namely AT Private Limited, whose statutory auditor is CA. B for the same financial year i.e., 2023-24.

CA. B issued a qualification in CARO 2020 for AT Private Limited, stating that short-term funds raised were utilised for long-term purposes. When consolidating the financial statements, CA. F decided to include the aforementioned qualification in the audit report of the Consolidated Financial Statements for the financial year 2023-24. The management of XYZ Limited argued that CA. F is not obligated to take into account and report the qualification given by CA. B in the audit report of the subsidiary company in the consolidated financial statements for the financial year 2023-24.

Discuss the reporting requirement as per CARO, 2020.

[RTP-Nov.23]

Ans: Reporting requirement as per CARO, 2020:

XYZ Limited is the parent company, and it has a subsidiary named AT Private Limited. CA F is the appointed statutory auditor for XYZ Limited for the financial year 2023-24. Another auditor, CA B, has conducted the statutory audit for AT Private Limited and issued a CARO 2020 report, which includes a qualification regarding the short-term funds raised and utilised for long-term purposes.

Provision of Paragraph 2 of CARO 2020: CARO provisions do not apply to the auditor's report on consolidated financial statements except for clause (xxi) of Paragraph 3.

Clause (xxi) of Paragraph 3 of CARO 2020: Clause (xxi) of Paragraph 3 of CARO 2020 mandates the auditor to comment on whether there are any qualifications or adverse remarks in the CARO reports of companies included in the consolidated financial statements. If such qualifications or adverse remarks exist, the auditor is required to provide details of the companies and the paragraph numbers of the CARO report containing those qualifications or adverse remarks.

CA F's Responsibility: Considering the provisions stated above, CA F, as the auditor of XYZ Limited's consolidated financial statements, is required to follow these steps:

- (a) **Report under Clause (xxi) of Paragraph 3 of CARO 2020:** CA F must include a comment in the consolidated financial statement's audit report regarding whether there are any qualifications or adverse remarks in the CARO reports of the companies included in the consolidated financial statements.
- (b) **Incorporate Qualification by CA B:** CA F should incorporate the qualification made by CA B (regarding short-term funds raised and utilized for long-term purposes in AT Private Limited) into the auditor's report for XYZ Limited's consolidated financial statements.
- (c) **Mention Paragraph Number:** CA F must also provide the paragraph number of CA B's CARO report where the qualification is stated.

Management's Contention: The management of XYZ Limited's contention that CA F is not required to consider and report CA B's qualification in the subsidiary's CARO report for the consolidated financial statements is not valid. As per the provisions, CA F is indeed required to report such qualifications as specified in Clause (xxi) of Paragraph 3 of CARO 2020.

Conclusion: Based on the information provided and the provisions of CARO 2020, CA F is obligated to incorporate the qualification from CA B's CARO report for AT Private Limited into the auditor's report for XYZ Limited's consolidated financial statements for the financial year 2022-23, as well as provide the necessary details as per the requirements of Clause (xxi) of Paragraph 3 of CARO 2020.

Chapter 12 – Digital Auditing & Assurance

12.5 - Emerging Technologies in Audit

Q.9A Long Age Foundations Ltd. (LAF), a pharmaceutical company, collected the data from some hospitals and their experts tried to understand medical needs of elderly people. After complete study, their experts developed an application where LAF will provide complete health care after charging a nominal amount from the customers, if customers download this application in their mobile phones. CA P in his audit has used data analytics method also known as Computer Assisted Audit Techniques. Give illustrations of suggested approach to get the benefit from the use of CAATs. [MTP-Sep. 23]

Ans: Suggested approach to get benefit from the use of CAATs

The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is as given below:

- (a) Understand Business Environment including IT.
- (b) Define the objectives and criteria.
- (c) Identify source and format of data.
- (d) Extract Data.
- (e) Verify the completeness and Accuracy of Extracted data.
- (f) Apply Criteria on data obtained.
- (g) Validate and confirm results.
- (h) Report and document results and conclusions (SA 230).

Q.9B	<p>In an automated environment, the data stored and processed in systems can be used to get various insights into the way business operates.</p> <p>This data can be useful for preparation of Management Information System (MIS) reports and electronic dashboards that give a high-level snapshot of business performance.</p> <p>In view of the above facts, you are required to briefly discuss the meaning of data analytics and give examples of circumstances, when auditors can apply the concept of data analytics.</p> <p style="text-align: right;">[Nov. 23 (4 Marks)]</p>
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Ans: Meaning of Data Analytics: Refer answer of Q. No. 8.

Circumstances when auditors can apply the concept of data analytics:

In an automated environment, auditors can apply the concept of data analytics for several aspects of an audit including the following:

1. Preliminary Analytics;
2. Risk Assessment;
3. Control Testing;
4. Non-Standard Journal Analysis;
5. Evaluation of Deficiencies;
6. Fraud Risk assessment.

Chapter 13 - Group Audits

13.1 - Concept of Consolidated Financial Statements

Q.8A	<p>Explain the provisions & requirements of the Companies Act, 2013 for preparation and Consolidation of Financial Statements of a company which is mandatory. Also, state in which cases the requirement related to preparation of consolidated financial statements shall not apply to a company.</p> <p style="text-align: right;">[Nov. 23 (5 Marks)]</p>
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Ans: Requirements for preparation and Consolidation of F.S.: Refer answer of Q. No. 1.

Cases where requirement related to preparation of Consolidated F.S. shall not apply to a company: Refer answer of Q. No. 2.

13.4 - Miscellaneous Questions

Q.29A	<p>CA Tushar is engagement partner conducting audit of consolidated financial statements of a group which includes parent entity and its 3 subsidiaries. The standalone financial statements of its subsidiaries are audited by component auditors. He is considering accepting such appointment. What specific considerations have to be kept in mind by him before accepting appointment as principal auditor of the group?</p> <p>After acceptance, he is in quandary with regard to determination of materiality during audit of consolidated financial statements. What specific considerations have to be kept in mind while determining materiality during audit of above group?</p> <p style="text-align: right;">[MTP-Oct. 23]</p>
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Ans: Specific considerations to be kept in mind before accepting appointment as principal auditor:

Refer answer of Q. No. 26

Specific considerations to be kept in mind while determining materiality:

Refer answer of Q. No. 21

Chapter 14A –Audit of Banks

14A.3 - Internal Control Procedures in Bank

- Q.4A** CA. Sundaram is an engagement partner conducting a statutory audit of a nationalised bank. The bank operates on the CBS platform, and the identification of NPAs is system based in accordance with RBI guidelines on asset classification. He wants to be assured of satisfactory operation of internal control in this respect. He wants to be sure that there exists an internal control system in the bank which not only prevents and reduces the risk of loan assets becoming non-performing at the initial stages but also sends out timely signals to the bank subsequently. He is putting considerable importance on effective credit appraisals due to their role in preventing NPA slippages.
- While carrying out a walk-through of internal control over advances of banks especially in areas of “credit appraisals” and “credit monitoring”, identify any four specific controls which you may be looking for. [RTP-Nov. 23]

Ans: Specific controls to be looked into in area of “credit appraisals” and “credit monitoring”:

The following controls may be considered by auditor in areas of credit appraisals and credit monitoring for ensuring that internal control over advances is effective and the system is capable of not only preventing and reducing the risk of NPAs at the sanction stage itself but also sending out timely signals to the bank subsequently.

- (i) Use of third-party data sources in the bank for comprehensive due diligence at the sanction stage itself to mitigate risk on account of misrepresentation and fraud.
- (ii) Classification of accounts as special mentioned accounts (SMA) for early recognition of signs of incipient stress resulting in default in timely servicing of debt obligations. It can enable banks to initiate timely remedial actions to prevent potential slippages into NPAs.
- (iii) Institution of comprehensive, automated Early Warning Systems (EWS) in banks with EWS triggers to detect stress and reduce slippage into NPAs
- (iv) Reporting of repayment behaviour of borrowers in their loan accounts to credit information companies and inclusion of this information in the credit appraisal and decision-making process for further sanctioning of loans to borrowers.

14A.6 - Verification of Advances

- Q.24A** Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom a variety of advances are granted. The audit of advances requires major attention from the auditors. As an expert in bank audit, you are required to briefly discuss the area of focus and suggested audit procedures regarding the evaluation of internal controls over advances, substantive audit procedures and recoverability of advances. [MTP-Sep. 23]

Ans: Audit procedures regarding the evaluation of internal controls over advances, substantive audit procedures and recoverability of advances:

Area of Focus	Suggested Audit Procedure
Evaluation of Internal Controls over Advances	<ul style="list-style-type: none"> • Examine loan documentation • Examine the validity of the recorded amounts • Examine the existence, enforceability and valuation of the security • Ensure compliance with the terms of sanction and end use of funds. • Ensure compliance with Loan Policy of Bank as well as RBI norms including appropriate classification and provisioning • Review the operation of the accounts

	Substantive Audit Procedures	<ul style="list-style-type: none"> • Check that the advances represent amount due to the bank • Verify that the advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements • Check that appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices. • Examine all large advances while other advances may be examined on a sample basis • Verify completeness and accuracy of interest being charged • Ensure that there are no unrecorded advances • Check that the stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation • Check whether the amounts included in the balance sheet are outstanding as on the date of balance sheet. • Verify completeness and accuracy of interest being charged.
	Recoverability of Advances	<ul style="list-style-type: none"> • Review periodic statements submitted by the borrowers indicating the extent of compliance with terms and conditions. • Review latest financial statements of borrowers. • Review reports on inspection of security. • Review Auditors' reports in the case of borrowers enjoying aggregate credit limits of ₹ 10 lakh or above for working capital from the banking system.

Q.24B PQS & Associates are one of the joint auditors of KNO Bank for the year 2023-24. While auditing KNO Bank, they are analysing industry data relating to NPAs in select public sector banks as part of risk assessment procedures:

Audit of Banks	Gross NPAs (in ₹ crore)	Net NPAs (in ₹ crore)	Ratio of Net NPAs to Net advances
BBI Bank	55,000	13,000	1.72%
DAB Bank	45,000	10,000	2.34%
CNI Bank	55,000	18,000	2.65%
KNO Bank	28,000	6,500	3.97%
BRB Bank	35,000	8,800	2.27%

In the above context, what do you understand by “Gross NPAs” and “Net NPAs” as on reporting date in the context of financial statements of a Bank? As an auditor of KNO Bank, what inference would you draw by comparing the “Ratio of net NPAs to net advances” with other public sector banks?

[RTP-Nov. 23]

Ans: Gross NPA and Net NPA:

- Gross NPAs represent opening balances of NPAs as increased by fresh NPAs during the year and reduced by upgradations, recoveries and write-offs during the year.
- Net NPAs are arrived at after deducting amounts on account of the total provision held against NPAs/ balance in the interest suspense account to park accrued interest on NPAs and certain other adjustments.

- The Net NPAs to Net advances ratio is higher in the case of KNO Bank as compared to other public sector banks. It shows that there is a risk that the bank could not have made the required provisions in accordance with RBI guidelines. A higher net NPAs to Net advances ratio indicates the probability and risk of under-provisioning. Keeping in view the above, audit procedures have to be tailored towards the examination and verification of this crucial area.

Q.24C MNS Bank Ltd. is suffering from huge number of NPAs. During the month of April 2023, the management of the bank decided to sell some of its NPAs. Bank is doing this exercise for the first time. The management has selected following NPA accounts for sale:

Name	NPA since F.Y.	Amount (₹ In Lakh)
S store Ltd.	2018-19	27.50
V Pvt. Ltd.	2017-18	55.23
AV Fab Corp.	2020-21	34.20
MN Iron works	2021-22	45.30
D G and Associates	2019-20	50.00

Being internal auditor of the bank, you are required to scrutinize the proposal made by the branch and help them by providing specific points to be considered. [Nov. 23 (4 Marks)]

Ans.: Specific Points to be considered in scrutinising sale of NPA:

Auditor should examine the followings:

- Policy laid down by the BoD relating to procedures, valuation and delegation of powers including non-performing financial assets that may be purchased/sold, norms for such purchase/sale, valuation procedure and accounting policy.
- Only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- Assets have been sold/ purchased 'without recourse' only *i.e.* the entire credit risk associated with the NPA should be transferred to the purchasing bank.
- Subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- NPA has been sold at cash basis only. Under no circumstances, NPA can be sold to another bank at a contingent price. The entire sale consideration has to be received on upfront basis.
- Bank has not purchased an NPA which it had originally sold.

Additional Points in case of Sale of an NPA: Auditor should ensure the following:

- On the sale of the NPA, the same has been removed from the books of account of selling bank on transfer;
- If the sale is at a price below the net book value (NBV) (*i.e.*, book value less provisions held), the shortfall should be debited to the profit and loss account of that year.
- If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/loss on account of sale of other non-performing financial assets.

In the given case, account of MN Iron Works is classified as NPA since 2021-22. One of the requirements for the sale of NOA that only such NPA can be sold which has remained NPA in the books of the bank for at least 2 years, is not satisfied. Internal Auditor should bring this matter into the knowledge of Branch manager.

Chapter 14B – Audit of Non-Banking Financial Companies

14B.5 - NBFC Auditor's Report (Reserve Bank) Directions, 2016

- Q.16A** Super Non-Bank Limited, a “Systemically Important Non-Deposit Taking Non-Banking Financial Company”, was operating appropriately till the start of COVID-19 Pandemic. Due to unforeseen conditions during the Pandemic and after that, the operating revenue of the NBFC started decreasing. Following were the position of Net Owned Funds of the company during the last 4 financial years:

Financial Year	Net Owned Funds
FY 19-20	₹ 15 Crore
FY 20-21	₹ 6 Crore
FY 21-22	₹ 4 Crore
FY 22-23	₹ 1.5 Crore

Super Non-Bank Limited appointed Mr Shyam as their statutory auditor for the FY 23-24. Mr. Shyam identified that the Net Owned Funds of the company have been less than ₹ 2 Crore since June 2022. Kindly guide Mr Shyam with respect to his reporting requirements as per relevant NBFC provisions.

[MTP-Sep. 23]

Ans: Reporting Requirements if NOF not maintained:

- In exercise of the powers conferred u/s 45 IA of the RBI Act, Bank hereby specifies ₹ 200 lakh as the Net Owned Fund (NOF) required for a NBFC to commence or carry on the business of non-banking financial institution, except wherever otherwise a specific requirement as to NOF is prescribed by the Bank.
- It will be incumbent upon such NBFCs, the NOF of which currently falls below ₹ 200 lakh, to submit a statutory auditor's certificate certifying compliance with the prescribed levels by the end of the period as given above.
- NBFCs failing to achieve the prescribed level within the stipulated period shall not be eligible to hold the CoR as NBFCs. Every NBFC shall submit a certificate from its Statutory Auditor that it is engaged in the business of a non-banking financial institution requiring it to hold a CoR u/s 45 IA of the RBI Act and is eligible to hold it. A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non banking financial company is registered, within one month from the date of finalization of the balance sheet and in any case not later than Dec. 30th of that year.

Conclusion: It is the responsibility of the Statutory Auditor, i.e., Mr Shyam, to report where NOF has fallen below ₹ 200 Lakhs

Note: For all companies currently applying for registration as a NBFC, minimum NOF requirement is ₹ 10 Crores (earlier it was ₹ 2 crores). All existing companies should meet NOF of ₹ 10 Crores in a phased manner by 31st March 2027.

14B.7 - Ind AS and Schedule III

- Q.21A** Suhana, a CA final student, is part of engagement team conducting audit of CMM Finance Limited, a listed NBFC. While going through THE audit programme, she notices that it contains instructions for verification of following matters among other things in relation to disclosure requirements of Schedule III of Companies Act, 2013:

- (i) Verification regarding disclosure of any of item of income or expenditure which exceeds 1% of revenue from operations or 10 lakhs whichever is higher.
- (ii) Verification of disclosure regarding Return on Capital Employed Ratio, return on Equity Ratio and net profit ratio

Discuss whether above instructions for similar matters need revision by engagement partner in this situation. If so, elaborate on revision required along with reasons. [MTP- Oct.23]

Ans: Disclosure requirements for a listed NBFC under Division III of Schedule III:

Instructions given are not proper and these do not pertain to Division III of Schedule III applicable to NBFCs. Rather, such requirements are applicable for companies for which Division II of Schedule III is applicable. Hence, these should be revised in accordance with similar requirements applicable to listed NBFCs for whom Division III of Schedule III is applicable.

Similar disclosure requirements for a listed NBFC under Division III of Schedule III are as follows: -

- (i) Any item of other income or other expenditure which exceeds 1% of total income
- (ii) Disclosure of the following ratios: -
- Capital to risks weighted assets ratio (CRAR)
 - Tier I CRAR
 - Tier II CRAR
 - Liquidity coverage ratio

Q.21B DK Finance Ltd. is registered with RBI as an NBFC. Its financial statements have already been prepared and approved. A US based company is interested in investing in the equity of DK finance Ltd. but they want the company to present their financial statements under IND AS.

What points do you think should be kept in mind while preparing the financial statements of an NBFC under IND AS? [Nov. 23 (5 Marks)]

Ans: Points to be kept in mind while preparing financial statements of an NBFC under IND AS:

Refer answer of Q. No. 21

Chapter 15 – Audit of Public Sectors Undertakings

15.1 - Basics of Audit of PSU

Q.2A The Comptroller & Auditor General of India plays a key role in functioning of financial committees of Parliament and state legislatures. Therefore, he has come to be recognized as a friend, philosopher and guide of committees. Discuss how such a role is ensured in practice. Also, briefly discuss the functions of “Estimates Committee” of Parliament. [MTP-Oct. 23]

Ans: Role of C&AG in functioning of Financial Committees: Refer answer of Q. No. 2.

Functions of “Estimates Committee”:

- (i) to report what economies, improvements in organization, efficiency or administrative reform, consistent with the policy underlying the estimates may be effected;
- (ii) to suggest alternative policies;
- (iii) to examine whether the money is well laid out within the limit; and
- (iv) to suggest the form in which the estimates shall be presented to Parliament.

Chapter 16 - Internal Audit

16.2 - Management Function and Scope of Internal Auditing

Q.9A Dreams Pvt. Ltd. is a Travel management Company which provides its customers with customized packages of domestic and international tours. During the period of COVID-19 and a year after that, company suffered losses due to which it went under cost cutting regime. As a part of the process, the company has adopted various courses of actions one of which is appointment of internal auditor. The internal auditor observed that the company has given a huge hall for providing a gym facility to its employees. The internal auditor observed that the gym is being used only 1-2 days a week on an average basis by the employees. There is a huge balance lying in the company's bank account, but the management could not take a decision regarding investing the same, due to fluctuating market situations. The Company has taken a hall on rent for the purpose of sitting cum waiting lounge for its customers. Besides, everyday there is downtime of one hour during the working hours for computers and other machines. The internal auditor of the company wants to cover these matters and report them, but Mr. X the manager of the company, is of the opinion that these matters are not related to internal audit and, therefore, should not be commented upon. Express your opinion in this regard and suggest appropriate course of action. [Nov. 23 (4 Marks)]

Ans: Scope of internal Audit:

The scope of internal auditor's work should, among other things, include a review of efficient and economical use of available resources. Or this purpose, internal auditor should:

- (i) Check whether proper operating standards and norms have been established for measuring economical & efficient use of resources.
- (ii) Operating Standards should be detailed enough to be identifiable with specific operating responsibilities and should be capable of being used by operating personnel for monitoring and evaluating their performance.
- (iii) Review methods of establishing operating standards and norms.
- (iv) Examine the assumptions made while setting the standards to ensure that they are appropriate and necessary.
- (v) Where there is a wide divergence between actual performance and corresponding standards, reasons may be considered.
- (vi) Identify facilities which are under-utilized, e.g. under-utilized machines, unoccupied storage space, huge cash or bank balances, idle manpower, etc.

Hence, in the given case, opinion of the manager is not correct. Commenting on the unoccupied storage space, idle cash balance etc. is well within scope of work of internal auditor.

16.3 - Integrity, Objectivity, Independence and Other Qualities of Internal Auditor

Q.10A Consider the following statement:
 "The internal auditor of a company shall be free from any undue influences which force him to deviate from the truth. He shall be independent."
 Is above statement proper? If so, how independence of internal auditor can be established?
[MTP- Oct. 23]

Ans: Independence of internal auditor:

- The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor

shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

- The independence of the internal audit function and the Internal Auditor within the organization is a vital aspect of maintaining effective corporate governance. It is important to ensure that the internal audit function is free from any undue influence or pressure that may affect its ability to provide impartial and objective assessments of the organization's operations, risks, and controls.

Conclusion: Statement that "The internal auditor of a company shall be free from any undue influences which force him to deviate from the truth. He shall be independent." is proper.

To establish the independence of the Internal auditor, several factors need to be considered.

- Firstly, the overall organizational structure of key personnel plays a crucial role. The Internal auditor should be positioned in a way that allows them to operate independently and objectively. This includes having direct access to the Audit Committee, Board of Directors, and other senior executives.
- Secondly, the reporting line of the Chief Internal Auditor is an important consideration. The Chief Internal Auditor should report to the highest level of authority within the organization, such as the CEO or the Board of Directors. This ensures that the Internal auditor has the necessary authority and support to carry out their responsibilities effectively.
- Finally, the powers and authority derived from superiors further establish the independence of the Internal auditor. The Internal auditor should have the necessary resources, budget, and support to conduct their work without any undue influence or pressure from senior executives or other stakeholders.

Chapter 17 – Due Diligence, Investigation & Forensic Audit

17.2 - Investigation

Q.14A CA. Kushal has been appointed as an Investigator by M/s. XYZ and Associates. While undertaking this assignment of investigation, the subordinate staff of CA. Kushal inquired about the following issues:

- Whether an investigator is required to undertake the cent per cent verification approach or whether he can adopt selective verification?
- Whether an investigator necessarily requires assistance of expert?
- Whether an investigator can retain working papers or not?

Guide CA. Kushal in solving the queries raised by his sub-ordinate staff.

[RTP-Nov. 23]

Ans: Investigations:

Investigations broadly range between two extremes; on the one hand there are those in respect of which complete accounts, documents, records and other information are available, and on the other, those in respect of which little information, besides published accounts and statistical data, is available. Then again, investigation may cover the whole of accounting or may relate to only a part or parts of accounting as may be specified. Some more issues often arise in investigation. They are stated below:

- Whether an investigator is required to undertake a cent per cent verification approach or whether he can adopt selective verification** - The answer to this question depends on the exact circumstances of the case under investigation. If the investigator has to establish the amount of cash defalcated by the cashier, he has probably no option but to carefully examine all the cash vouchers and related records. On the other hand, if he is to arrive at the profitability of

a concern, he may verify constituent transactions on a selective basis taking extreme care to see that no material transaction that affects profit has remained concealed from his eyes. In investigation, it is always safer to go by statistically recognised sampling methods than to depend on the so-called “test checks” where circumstances permit selective verification.

- (b) **Whether an investigator necessarily requires assistance of expert** - Often an investigator may feel the necessity of obtaining views and opinions of experts in various fields to properly conduct the investigation. It would be therefore, proper for the investigator to get the written general consent of his client, to refer special matters for views of different experts at the beginning of investigation and he should settle the question of costs for obtaining the views and other related implications.
- (c) **Whether to retain working papers or not** - Another important precaution is that the investigating accountant should retain in his files full notes of the work carried out, copies of schedules and all working papers, annexures, facts, figures, record of conversations and the like. Also, the working papers should link up the figures as shown by the books of business with the final figures produced by the investigating accountant. Wherever required the investigator should take representation letter from the appointing authority. In the absence thereof, he would not be able to explain the figures when he is called upon to give evidence in a court of law to support his figures; for quite often the conclusions of the accountant are challenged by parties whose interest is adversely affected by his findings, for example, when the value of shares of a company taken over by the Government has been determined by him. This will also be of immense help to the investigator in correlating facts and events and later in drafting the report.

Chapter 19 – Professional Ethics & Liabilities of Auditors

19.1 - Fundamental Principles, Threats and NOCLAR

- Q.5A** CA X has issued report in Form 29B under the Income-tax Act, 1961 wrongly computing “book profits” of a company for financial year 2021-22. He has signed the said form hurriedly without ascertaining the required adjustments to be made for arriving at the “book profits” of the company. Subsequently, the company’s ITR was picked up for scrutiny under the faceless assessment scheme on 29.6.23, and the matter came to light of tax authorities. Which fundamental principle of professional ethics is violated in this situation? Also, discuss the liability of CA X, if any, under the Income Tax Act in this respect. [MTP-Oct. 23]

Ans: Violation of Fundamental Principles:

The principle of integrity requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness. A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information: -

- Contains a materially false or misleading statement.
- Contains statements or information provided negligently; or
- Omits or obscures required information where such omission or obscurity would be misleading.

Under Section 271 J of the Income Tax Act, if an accountant, merchant banker or registered valuer furnishes incorrect information in a report or certificate under any provisions of the Act or rules made thereunder, the assessing officer or Commissioner (Appeals) during the course of any proceedings under the Income Tax Act may direct him to pay a penalty of ₹ 10000 for each such certificate or report. Therefore, he can be liable to a penalty of ₹ 10000 for wrong certification.

19.2 - Membership of the Institute; CAs in Practice and KYC Norms

Q.17A Mr. Raj, a practicing Chartered Accountant was ordered to surrender his certificate of practice and he was suspended for two years for accepting the appointment as an auditor of a company without ascertaining the requirements of section 139 and 140 read with section 141 of Companies Act, 2013. During the period of suspension, Mr. Raj, designating himself as Data Privacy consultant, did the work of filing Data Privacy related returns and made appearance as a consultant before various related authorities in other capacity other than Chartered Accountant in Practice. He contended that there is nothing wrong in it as he, like any other consultant, could take such work and his engagement as such in no way violate the order of suspension inflicted on him.

Kindly guide Mr. Raj whether can he appear before various Data Privacy related authorities when he is under period of suspension in light of section 6 of the Chartered Accountants Act, 1949.

[MTP-Oct. 23]

Ans: Practice as a Chartered Accountant:

Section 6 of the Chartered Accountants Act, 1949 provides that: -

(i) No member of the Institute shall be entitled to practise whether in India or elsewhere unless he has obtained from the Council a certificate of practice:

It may be noted that this provision is not applicable to any person who, immediately before the commencement of this Act, has been in practice as a registered accountant or a holder of a restricted certificate until one month has elapsed from the date of the first meeting of the Council.

(ii) Every such member shall pay such annual fee for his certificate as may be determined, by notification, by the Council.

(iii) The certificate of practice obtained under sub section (1) may be cancelled by the Council under such circumstances as may be prescribed.

Once the person concerned becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act and its Regulations. If and when he appears before the Income-tax Tribunal as an Income-tax representative after having become a member of the Institute, he could so appear only in his capacity as a Chartered Accountant and a member of the Institute. Having, as it were, brought himself within the jurisdiction of the Chartered Accountants Act and its Regulations, he could not set them at naught by contending that even though he continues to be a member of the Institute and has been punished by suspension from practice as a member, he would be entitled, in substance, to practice in some other capacity.

In the current case, Mr. Raj, designating himself as Data Privacy consultant, did the work of filing Data Privacy related returns and made appearance as a consultant before various related authorities in other capacity other than Chartered Accountant in Practice.

Conclusion: As Mr. Raj is not appearing in the capacity of Chartered Accountant in Practice and hence he is not violating the suspension order.

19.3 - First Schedule Part I – Professional Misconduct in Relation to Members in Practice

Q.58A Mr. Sunil was appointed statutory Auditor of M. Autotech Limited after Mr. Ram resigned from the position of auditor on 31-07-2022 for the financial year 22-23. Mr. Sunil received the appointment letter duly signed by the Board of Directors and a resolution of the Audit Committee recommending the name of Mr. Sunil to the Board. Mr. Sunil received the letter of appointment on 31-07-2022, which he accepted on 01-08-2022. On 15-08-2022, Mr. Sunil fixed a meeting with Mr. Ram to understand the reasons for his resignation and any concerns he should be aware of about the company. Prior to this, Mr. Sunil had not communicated with Mr. Ram. The Board of M Autotech Limited filed ADT-1 with the registrar on 31-08-2022.

Mr. Sunil, after performing the audit, issued his audit report on 31-05-2023. The registrar, after issuance of the audit report, suo moto initiated an inquiry regarding the appointment of Mr. Sunil as the auditor of the company. After the inquiry, Registrar issued a report to ICAI wherein it was mentioned that Mr Sunil should be held guilty of professional misconduct. You are required to guide Mr. Sunil with respect to the recommendation of the registrar for him being guilty of professional misconduct. [MTP-Sep. 23]

Ans: Non-Compliance of Sec. 139 and 140 of Companies Act, 2013:

- A member in practice shall be held guilty of professional misconduct as per clause 9 of Part I of the First Schedule where he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Sections 139 and 140 of Companies Act, 2013 in respect of such appointment have been duly complied with.
- Clause (9) of Part I of First Schedule to CA Act, 1949 provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a Company without first ascertaining from it whether the requirements of Sections 139 and 140 of the Companies Act, 2013, in respect of such appointment have been duly complied with. Under this clause, it is obligatory for the incoming auditor to ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.
- As per Sec. 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor General of India, be filled by the Board of Directors within thirty days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.
- Also, before such appointment is made, the written consent of the auditor to such appointment and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed shall be obtained from the auditor. Provided also that the certificate shall also indicate whether the auditor satisfies the criteria provided in section 141. Also, that the company shall inform the auditor concerned of his or his appointment and also file a notice of such appointment with the Registrar within fifteen days of the meeting in which the auditor is appointed.
- Also, a member in practice shall be held guilty of professional misconduct as per clause 8 of Part I of the First Schedule where he accepts a position as auditor previously held by another Chartered Accountant without first communicating with him in writing.
- In the current case, Mr Sunil was appointed statutory Auditor of M Autotech Limited after Mr Ram resigned from the position of auditor on 31.07.2022 for the financial year 2022-23. Mr Sunil received the appointment letter duly signed by the Board of Directors. Mr Sunil received the letter of appointment on 31.07.2022, which he accepted on 01.08.2022. On 15.08.2022, Mr Sunil fixed a meeting with Mr Ram to understand the reasons for his resignation and any concerns he should be aware of about the company. Prior to this, no communication happened between Mr Sunil and Mr Ram. The Board of M Autotech Limited filed ADT 1 with the registrar on 31.08.2022.
- Hence, Mr Sunil did not verify whether the requirement of section 139 of the Companies Act, 2013 has been complied with or not, as in the current case, there was no approval by the company at a general meeting convened within 3 months of recommendation of the Board. U/s 139(8), approval by a company at general meeting as discussed above is mandatory requirement.

	<ul style="list-style-type: none"> Therefore, he has not ascertained from company whether requirements of section 139 and 140 of Companies Act, 2013 have been complied with. Moreover, Mr. Sunil did not communicate with a retiring auditor in such a manner as to retain in their hands positive evidence of the delivery of the communication to the outgoing/previous auditor. <p>Conclusion: Mr. Sunil is guilty of professional misconduct both under clause 8 and 9 of First Schedule to Chartered Accountants Act, 1949.</p>
Q.70A	<p>CA Sumati is a practicing chartered accountant having office in Mumbai. CA Sumati is owner of domain cap.net. In order to generate additional revenue CA Sumati sold this domain name to XYZ Limited for earning royalty of ₹ 2,25,000. One of the directors of XYZ Limited contended that CA Sumati has violated the Code of Conduct. CA Sumati responded that there is no violation of Code of Conduct as selling of domain name is not related to any professional assignment which requires approval of the Institute. [RTP-Nov. 23]</p> <p>Ans: Engagements into other Occupations:</p> <ul style="list-style-type: none"> As per Clause (11) of Part I of Schedule I to the Chartered Accountants Act, 1949, a member in practice is deemed to be guilty if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being a managing director or a whole-time director) unless he or any of his partners is interested in such company as an auditor. As per Regulation 190A, a chartered accountant in practice not to engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. In the given case, CA Sumati is a practicing chartered accountant having office in Mumbai. CA Sumati is owner of domain cap.net. In order to generate additional revenue, CA Sumati sold this domain name for earning royalty of ₹ 2,50,000 to XYZ Limited. One of the directors of XYZ Limited contended that CA Sumati has violated the Code of Conduct. CA Sumati responded that there is no violation of Code of Conduct as selling of domain name is not related to any professional assignment which requires approval of the Institute. As per Regulation 190A, the activity of selling domain name for earning Royalty would amount to "other business/occupation" without approval is prohibited. <p>Conclusion: CA Sumati is guilty of professional misconduct under Clause 11 of Part I of Schedule I to the Chartered Accountants Act, 1949 for selling domain name for a royalty.</p>
Q.70B	<p>CA. Sonu has been practising since 2008, specialising in corporate audits and Company Law matters. Due to his good practical knowledge, he was offered editorship of a 'Company Audit' Journal, which he accepted. However, he did not take any permission from the Council regarding such editorship.</p> <p>Discuss the act of CA Sonu with reference to the Chartered Accountants Act, 1949 and the Rules made thereunder. [Nov. 23 (4 Marks)]</p> <p>Ans: Engagement in other occupations:</p> <ul style="list-style-type: none"> Clause 11 of Part I of First Schedule to the CA Act, 1949 prohibits a member in practice to engage in any business or occupation other than the profession of chartered accountants unless permitted by the Council so to engage. It does not prohibit a CA from being a director of a company, except MD or a whole-time director. But if any of the partners is interested in such company as an auditor then he cannot be director of the said company.

- General permission is granted under Regulation 190A for being appointed as editor of professional journal.
 - In the present case, CA Sonu was offered editorship of a 'Company Audit' Journal, which he accepted. However, he did not take any permission from the Council regarding such editorship.
- Conclusion:** Clause 11 permits editorship of professional journals, hence no misconduct arises on part of Mr. Sonu.

19.4 - First Schedule, Part II–Professional Misconduct in relation to Members in Service

Q.78A CA D is serving as Vice-President (finance) of TM Industries, a firm. A huge claim lodged by firm for ₹ 20 crores with an insurance company was just paid for ₹ 2 crores. Aggrieved by it, management of TM Industries has decided to go in for arbitration proceedings under Arbitration and Conciliation Act, 1996. Unaware of lawyers dealing in this field, management requests CA D to help them find out a suitable lawyer. Being a smart person, CA D has links with one such lawyer. His understanding with arbitration lawyer was to receive 25% of fees agreed between lawyer and client by way of commission. Comment whether CA D is guilty of professional conduct. [MTP-Oct. 23]

Ans: Professional Misconduct of a member in service:

- Part II of First Schedule of Chartered Accountants Act, 1949 deals with professional misconduct in relation to members of Institute in service.
- Clause 2 of Part II of First Schedule to CA Act, 1949 states that a member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant or broker engaged by such Company, firm or person or agent or customer of such Company, firm or person by way of commission or gratification.

Conclusion: CA D is guilty of professional misconduct as discussed above.

19.9 - Council General Guidelines, 2008

Q.132 A Statutory Audit of Arihant Limited for the year 2022-23 was done by CA Acharya. Arihant Limited was in existence since 2010. The relevant extract from books of account of Arihant Limited are as below:

Particulars	As at 31.03.2024 (₹ in lakh) (Unaudited)	As at 31.03.2023 (₹ in lakh) (Audited)
Equity Share Capital	5.00	5.00
Reserve and Surplus	(10.00)	(8.00)
Provision for Audit Fees	For FY 2021-22: 1.00 For FY 2022-23: 1.00	1.00
(Figures in bracket indicates negative values)		

CA. Nemi accepted the Statutory Audit of Arihant Limited for the year 2023-24 in spite of the fact that as on date of acceptance by CA Nemi, the audit fees of CA Acharya was unpaid. [RTP-Nov. 23]

Ans: Contravention of Council general Guidelines, 2008:

- As per Chapter VII of Central Council Guidelines 2008, a member of the Institute in practice shall not accept the appointment as auditor of an entity in case the undisputed audit fee of another Chartered Accountant for carrying out the statutory audit under the Companies Act, 2013 or various other statutes has not been paid:

Provided that in the case of sick unit, the above prohibition of acceptance shall not apply where a sick unit is defined to mean "where the net worth is negative as at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

- As Explanation 1 of the Chapter VII of Central Council Guidelines 2008, for the purpose, the provision for audit fee in accounts signed by both - the auditee and the auditor along with other expenses, if any, incurred by the auditor in connection with the audit, shall be considered as "undisputed audit fees".

Conclusion: In the instant case, though the undisputed fees are unpaid, CA Nemi would still not be guilty of professional misconduct since the Arihant Limited is a sick unit having negative net worth for the year 2023-24.

19.11- Miscellaneous

- Q.134**
A **Mr. R has been appointed as the statutory auditor of Famous Ltd. which is a listed company. As per the terms of acceptance of audit, the whole audit fee shall be payable in four instalments of ₹ 3 lakh each, and shall be paid after every limited review done on quarterly basis and conclusion of audit committee meeting of every quarter. Full and final payment shall be done after the yearly financial statements and Audit Reports are released. The firm received first two payments on time while third payment which was supposed to be received in the month of January was received on March 25th, 2023 along with the remaining part of Audit Fee.**
- Discuss the validity of above fee structure and terms of payment in the light of applicable provisions given by ICAI.** **[Nov. 23 (4 Marks)]**

Ans: Fees Structure and terms of Payment:

The Committee for Members in Practice (CMP) of ICAI as a part of its commitment to strengthen the Practitioners has initiated the Revised Minimum Recommended Scale of Fees for the professional assignments done by the members of ICAI. The recommendation is about the fee to be charged as per the work performed for various professional assignments. Various norms prescribed are:

- Fees to be charged depending on the complexity and the time spent on the particular assignment.
- Recommended minimum scale of fees is as recommended by the Committee for Members in Practice. However, members are free to charge varying rates depending upon the nature and complexity of assignment and time involved in completing the same.
- It is also recommended that the bill for each service should be raised separately and immediately after the services are rendered.

Guidelines are silent as to the manner in which fees is to be structured and terms of payment. However, receipt of audit fees in advance will be treated as indebtedness and may render a member/firm disqualified to continue as auditor. However, fees may be received on progressive basis.

In the given case, total fees payable is ₹ 12 lakh payable in four instalments of ₹ 3 lakh each and shall be paid after every limited review done on quarterly basis and conclusion of audit committee meeting of every quarter. Full and final payment shall be done after the yearly financial statements and Audit Reports are released. The firm received first two payments on time while third payment which was supposed to be received in the month of January was received on March 25th, 2023 along with the remaining part of Audit Fee.

Conclusion: In the absence of any specific provision as to fees structure and terms of payment, nothing seems to be contrary to any provision.

Note: Alternate answer possible with different assumption.

PART II - MULTIPLE CHOICE QUESTIONS

Chapter 1 – Quality Control

- 1** Mr. C, auditor of a listed company, DEX Limited, signed its audit report on 21.8.2022. The regulator called the audit file in connection with some proceedings on 20.7.2023. He submitted audit files in the form of editable Excel files without any security feature on 10.8.2023. It later transpired that the audit file was modified between 20.7.2023 and 10.8.2023 by deleting certain information and adding fresh information in its place. Which of the following statements is likely to be correct in this regard?
- (a) Audit file was required to be assembled by 21.8.2022. Modification in the audit file after 21.8.2022 was generally not permissible.
- (b) Audit file was required to be assembled by 21.8.2022. Modification in the audit file before 20.7.2023 was generally permissible.
- (c) Audit file was required to be assembled by 20.10.2022. Modification in the audit file before 20.7.2023 was generally permissible.
- (d) Audit file was required to be assembled by 20.10.2022. Modification in the audit file after 20.10.2022 was generally not permissible except in certain exceptional circumstances. [MTP-Oct. 23]

Chapter 2 – General Auditing Principles and Auditors Responsibilities

- 2** X, Y and Z are joint auditors of a company engaged in manufacturing of chemicals. They have developed a joint audit plan and identified common areas. Besides, they have also identified and allocated work by signing work allocation documents among themselves. Verification of trade receivables was allocated to Z. Which of the following statements is in accordance with relevant SA in this regard?
- (a) X and Y should necessarily review work performed by Z to ascertain whether work has been actually performed in accordance with Standards on Auditing.
- (b) X and Y should perform tests to ascertain whether work has been actually performed in accordance with Standards on Auditing.
- (c) X and Y are entitled to assume that Z has actually performed work in accordance with Standards on Auditing.
- (d) X and Y are not entitled to assume that Z shall bring to their notice significant observations relevant to responsibilities noticed during the course of the audit. [MTP-Oct. 23]

Chapter 4 – Materiality, Risk Assessment and Internal Control

- 3** COBIT is _____
- (a) best practice IT governance and management framework published by Information Systems Audit and Control Association (ISACA). It provides the required tools, resources and guidelines that are relevant to IT governance, risk, compliance and information security.
- (b) one of the most popular frameworks for improving critical infrastructure cyber security published by National Institute of Standards and Technology (NIST).
- (c) the most widely adopted information security standard for the payments card industry issued by Payment Card Industry Security Standards Council (PCI SSC).
- (d) set of best practice processes and procedures for IT services management in a company like change management, incident management, problem management, IT operations and IT asset management in accordance with ISO 20000. [MTP-Oct. 23]

4	<p>CA P, as part of a statutory audit exercise, is testing a company's internal controls over purchase orders it places for acquiring capital assets. The company places huge orders for the acquisition of capital assets every year, keeping in view the nature of its business and corresponding requirements. While testing controls in a sample of purchase orders for the acquisition of capital assets, he failed to notice a lack of adherence to certain established parameters for placing such orders. The above situation is indicative of _____</p> <p>(a) Sampling risk. (b) Non-sampling risk. (c) Control risk. (d) Inherent risk.</p> <p style="text-align: right;">[MTP-Oct. 23]</p>
5	<p>“Performance materiality” means the amount or amounts set by the auditor at ___ than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements _____ materiality for the financial statements as a whole.</p> <p>(a) higher, exceeds. (b) less, exceeds. (c) less, falls below. (d) higher, falls below.</p> <p style="text-align: right;">[MTP-Oct. 23]</p>

Chapter 5 – Audit Evidence

6	<p>CA. Vishudh is auditor of a company having 15 inventory locations in the country. In view of multiple inventory locations and logistics issues involved, he decides not to attend physical inventory count process of the company. The company management also sends him digital evidence comprising of videos of inventory counting process at different locations as on reporting date with date and time stampings. Besides verifying inventory records, he also performs alternative audit procedures like examining details of subsequent sales of specific inventory items acquired prior to physical inventory counting. Which of following statements is most appropriate in this regard?</p> <p>(a) The procedure adopted by auditor is in accordance with Standards on Auditing as the auditor has obtained digital evidence with date and time stampings and also performed alternative audit procedures. (b) The procedure adopted by auditor is in accordance with Standards on Auditing. However, type of digital evidence obtained, and kind of alternative audit procedures performed do not constitute sufficient appropriate audit evidence. (c) The procedure adopted by auditor is not in accordance with Standards on Auditing as auditor can skip attendance at inventory counting only when attending it is unfeasible. (d) The procedure adopted by auditor is in accordance with Standards on Auditing as auditor can skip attendance at inventory count due to time, difficulty and logistics issues involved.</p> <p style="text-align: right;">[RTP-Nov. 23]</p>
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Chapter 7 – Reporting

7	<p>CA Aarti is in the midst of performing audit procedures in the month of March 2024 for conducting a statutory audit of “Tess Products Private Limited” engaged in manufacturing of footwear products for the year 2023-24. The turnover of the company as per profit and loss account for the immediately preceding financial year is ₹ 35 crores. In the last week of March 2024, she gathered that the turnover of the company during the year 2023-24 would also be just nearing ₹ 35 crores. The company is also registered as a “Small Enterprise” under the Micro, Small and Medium Enterprises Development Act, 2006.</p>
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	<p>Its present paid-up share capital is ₹ 3.50 crores, which has remained unchanged for the past few years. Besides, it is availing and utilizing a working capital credit facility of ₹ 2 crores from a bank during all these years, including the year 2023-24. The company has acquired all shares of a company based in Hong Kong during the year 2023-24. She wants to be sure about the applicability or otherwise of CARO 2020 for suitably planning and directing her audit procedures for year 2023-24. Identify likely correct statement in this regard:</p> <p>(a) Reporting under CARO, 2020 would not be applicable as it is a small company. (b) Reporting under CARO, 2020 would not be applicable as it is registered as a small enterprise under Micro, Small and Medium Enterprises Act, 2006. (c) Reporting under CARO, 2020 would be applicable as it is not a small company. (d) Reporting under CARO, 2020 would not be applicable as it meets certain threshold criteria prescribed for private companies.</p> <p style="text-align: right;">[MTP-Oct. 23]</p>
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Chapter 19 - Professional Ethics & Liabilities of Auditors

8	<p>CA Mridul has been appointed as statutory auditor of PQT Limited, a reputed listed company engaged in the manufacturing of electronic products, in accordance with provisions of the Companies Act, 2013. Currently, he is also actively involved in advising the government in favour of proposed legislation likely to be introduced in one of the coming sessions of Parliament to attract investments and cutting-edge technology in the electronic products sector on behalf of his client. He has participated in TV programmes on the matter, written articles in business papers on the subject, and given key suggestions to the government in this regard. In all public appearances and statements, he has openly stated the fact of being associated with PQT Limited in the capacity of auditor. Which of the following statements is likely to be correct in this regard?</p> <p>(a) The described situation can involve self-interest threats to the independence of the auditor. (b) The described situation can involve familiarity threats to the independence of the auditor. (c) The described situation can involve advocacy threats to the independence of the auditor. (d) The described situation can involve self-review threats to the independence of the auditor.</p> <p style="text-align: right;">[MTP-Oct. 23]</p>
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Answer Key		
Q. No.	Answer	
1	(d)	Audit file was required to be assembled by 20.10.2022. Modification in the audit file after 20.10.2022 was generally not permissible except in certain exceptional circumstances.
2	(c)	X and Y are entitled to assume that Z has actually performed work in accordance with Standards on Auditing.
3	(a)	best practice IT governance and management framework published by Information Systems Audit and Control Association (ISACA). It provides the required tools, resources and guidelines that are relevant to IT governance, risk, compliance and information security.
4	(b)	Non-sampling risk.
5	(b)	less, exceeds.
6	(c)	The procedure adopted by auditor is not in accordance with Standards on Auditing as auditor can skip attendance at inventory counting only when attending it is unfeasible.
7	(c)	Reporting under CARO, 2020 would be applicable as it is not a small company.
8	(c)	The described situation can involve advocacy threats to the independence of the auditor.

PART III - INTEGRATED CASE SCENARIO

Chapter 4 – Materiality, Risk Assessment and Internal Control

Integrated Case Scenario - 1

ABC Ltd. is in the business of trading garments. Within a span of five years since its incorporation, the company has gained a good market reputation. Last year, in its Kochi warehouse the inventory was less than 1% of total inventory value, so the auditor instead of witnessing or performing the physical count of inventory relied upon the management's inventory confirmation and management in turn relied upon the warehouse keeper's stock register without verifying the actual count. The same year there was some difference between the store register and books of accounts closing balance. The management considered it to be an immaterial amount and wrote it off through "Miscellaneous Profit and Loss Account".

In the current year, while performing analytical procedure, the auditor saw a significant reduction in sales through Kochi warehouse, whereas there was a spike in freight charges to Kochi. Through further examination, the auditor noticed that there was increase in number of shipments to Kochi and increase in number of invoice cancellation instances and sales return instances from the customers of GST unregistered category. However, this year the inventory lying at Kochi is 4.5% as per books.

The Auditor enquired on the periodicity of physical verification and sales process through Kochi warehouse. The management gave the following response to the auditor:

1. The physical verification takes place every six months and the warehouse keeper is responsible for physical verification and sending records back to the head office.
2. Because of low operations in past years the warehouse keeper himself takes care of invoicing and dispatching the goods.
3. Monthly invoice details along with the monthly stock register is sent to the head office.
4. Further, this year too there is a substantial difference among inventory as per books, inventory as per stock register and inventory as per physical verification in descending order.

The auditor decided to visit the Kochi warehouse and conduct the root cause analysis and get the correct closing value of the inventory.

After the visit, the auditor concluded that the warehouse keeper was issuing the stocks with invoices, however on the sales return the credit notes were issued to various customers and the entry was made in the stock register of "Goods received on sales return" but physically the goods were never returned.

The Auditor also doubts that the same instance might have happened last year as well because of which there was a difference between physical stock and the books.

On this information, the management has asked auditor that why this was not brought into notice last year and whether the audit not conducted properly then. Further, a consultant was appointed by the management for the overview of internal controls with regard to verification of inventory and suggest recommendations.

On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs: [ICAI-Practice Question]

Q.1 In the view of the above case scenario, which according to you is the correct statement.

- (a) Only the errors can be expected to be identified during the audit.
- (b) Only the statutory compliance can be expected out of a Statutory Audit.

	<p>(c) The Auditor contends that last year the inventory levels in Kochi was not in the sampling materiality level and therefore, the issue was not identified. This is a part of the audit risk.</p> <p>(d) The Management is of the view that all the frauds and errors must be identified with the statutory audit.</p>
Q.2	<p>Which components of audit risks are represented in the aforesaid scenario?</p> <p>(a) Inherent Risk & Control Risk – Inherent risk due to its nature of business or operations and Control risk due to inappropriate design and ineffective implementation of internal controls.</p> <p>(b) Control Risk & Detection risk- Control risk due to inappropriate design and ineffective implementation of internal controls and audit detection risk due to possibility of auditor not identifying risk of misstatement.</p> <p>(c) Fraud risk due to nature and size of operations and high likelihood of fraud due to its significance.</p> <p>(d) Risk of Error because there was error in the presentation in the financial statement last year.</p>
Q.3	<p>Which Internal Control seems to have been compromised as the root cause here?</p> <p>(a) Lack in safeguarding the assets of company.</p> <p>(b) Lapse in compliance controls leading to non-compliance of sharing inventory level with the GST department.</p> <p>(c) Segregation of Duty.</p> <p>(d) Inadequate Records and Documents leading to non-recording of correct inventory value.</p>
Q.4	<p>To ensure that such instances are not taking place in other warehouses as well, the management wants to get an audit done. Which of the following audits is right in the above case scenario:</p> <p>(a) Management Audit as there seems to be a lapse at decision making.</p> <p>(b) Internal Audit as there seems to be lapse in internal control system and other such lapses in internal controls can also be identified.</p> <p>(c) Operational Audit as there is lapse in general working of operations.</p> <p>(d) Tax Audit as the Tax Auditor needs to value the inventory and identify the differences.</p>
Q.5	<p>Which Segregation of Duties aspect seems to have been compromised here?</p> <p>(a) Authorization, Execution & Record keeping.</p> <p>(b) Authorization, Execution & Custodian.</p> <p>(c) Execution, Custodian & Record keeping.</p> <p>(d) Custodian, Record keeping & Authorization.</p>

Answer – Integrated Case Study 1

Q. No.	Answer
1	(c) The Auditor contends that last year the inventory levels in Kochi was not in the sampling materiality level and therefore, the issue was not identified. This is a part of the audit risk.
2	(b) Control Risk & Detection risk- Control risk due to inappropriate design and ineffective implementation of internal controls and audit detection risk due to possibility of auditor not identifying risk of misstatement.
3	(c) Segregation of Duty.
4	(b) Internal Audit as there seems to be lapse in internal control system and other such lapses in internal controls can also be identified.
5	(c) Execution, Custodian & Record keeping.

Chapter 7 – Reporting

Integrated Case Scenario – 2

CA Paras is in the midst of conducting statutory audit for the year 2023-24 of “Meto Chemicals Limited”, a listed company. He is collating information required for reporting under CARO, 2020 from management. Audit procedures as are necessary in the circumstances will be performed on the information so obtained. The company’s revenue from sale of products is ₹ 15,000 crore. During the course of this exercise, he obtained the following information:

(A) The management has provided the following details of dues that have not been deposited on 31st March, 2024 on account of disputes: -

Name of Statute	Nature of dues	Forum where the dispute is pending	Period to which the amount relates	Amount involved (₹ in crore)	Amount unpaid (₹ in crore)	Other comments
Income-tax Act, 1961	Income Tax	CIT (Appeals)	AY 19-20	50.00	50.00	
Income-tax Act, 1961	Income Tax	ITAT	AY 15-16	10.00	10.00	Demand stayed by ITAT pending completion of hearing by the tribunal
EPF Act	PF contributions	Hon’ble High Court of Rajasthan	FY 18-19	0.10	0.10	
Municipal Corporation Act	Property tax	Hon’ble High Court of Rajasthan	FY 16-17	0.15	0.15	

The company has already made a provision of ₹ 10 crore in its financial statements considering the likely outcome of ongoing matters under dispute at ITAT. However, no provision has been made in respect of income tax matters pending before CIT(Appeals), PF contribution matter and property tax matter pending before Hon’ble High Court.

(B) The following information is available from financial statements/records of the company. (₹ in crore)

Non-Current assets	As at 31.03.24	As at 31.03.23
Property, Plant and Equipment	3,500	4,000
Right-of-use assets	750	700
Intangible assets	42	40

Values stated above are as per gross block.

Right-of-use assets consist of leases where the company has obtained the right-of-use asset under lease agreement in accordance with Ind AS 116.

- (C) **Meto Chemicals Limited produces goods for which the Central Government has specified maintenance of cost records. Besides, cost audit has also been mandated u/s 148(2) of the Companies Act. The cost auditor has already examined cost records and issued the cost audit report.**
- (D) **During the course of audit, CA Paras has found that physical verification of inventories of the company has been conducted during the year by management. The following is a summary of inventory as per physical verification conducted by management vis-à-vis its books of account as at the year-end:**

(Amount ₹ In crores)		
Particulars	As per physical verification	As per books of account
Raw material	1,000	1,020
Work-in-progress	200	220
Finished goods	2,000	2,290
Stores and spares	150	120
Total	3,350	3,650

- (E) **During the course of audit, he is informed by management that two supervisory employees have been dismissed from service due to fraud of ₹ 25 lakh committed by them during the year 2023-24. The amount has also been subsequently recovered from them during the year itself.**

On the basis of the abovementioned facts, you are required to answer the following MCQs:

[MTP-Sep. 23]

- Q.1 Select the correct statement relating to reporting of statutory dues which have not been deposited on account of disputes under clause 3(vii)(b) of CARO, 2020?**
- (a) Only matters relating to income tax pending before CIT (Appeals) and PF contribution matter pending before Hon'ble High Court need to be reported.
 - (b) Only Income tax matter pending before ITAT needs to be reported.
 - (c) All the four matters for which information has been provided in the fact pattern need to be reported.
 - (d) Income tax matter pending before CIT (Appeals), PF contribution matter and property tax matter pending before Hon'ble High Court need to be reported, matter pending with ITAT does not require reporting.
- Q.2 Identify the correct statement relating to reporting duties of the auditor under clause 3(i) of CARO, 2020 with regard to:**
- (a) It is the duty of the auditor to report whether company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment. Similarly, there is a duty to report on whether company is maintaining proper records showing full particulars of intangible assets. However, this duty does not extend to reporting on maintenance of records for Right-of-use assets.
Further, auditor has to report on whether Property, Plant and Equipment have been physically verified by management at reasonable intervals. This duty to report on physical verification by management does not extend to Right-of-use assets.
 - (b) It is the duty of the auditor to report whether company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment. This duty also applies to reporting on maintenance of records for Right-of-use assets and intangible assets.
Further, auditor has to report on whether Property, Plant and Equipment have been physically verified by management at reasonable intervals. This duty to report on physical verification by management also extends to Right-of-use assets.

	<p>(c) It is the duty of the auditor to report whether company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment. This duty does not extend to reporting on maintenance of records for Right-of-use assets and intangible assets.</p> <p>Further, auditor has to report on whether Property, Plant and Equipment have been physically verified by management at reasonable intervals. This duty to report on physical verification by management does not extend to Right-of-use assets.</p> <p>(d) It is the duty of the auditor to report whether company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment. This duty also applies to reporting on maintenance of records for Right-of-use assets and intangible assets.</p> <p>Further, auditor has to report on whether Property, Plant and Equipment have been physically verified by management at reasonable intervals. However, this duty to report on physical verification by management does not extend to Right-of-use assets.</p>
Q.3	<p>As regards cost records is concerned, which of the following statement is correct regarding reporting under clause 3(vi) of CARO, 2020?</p> <p>(a) The auditor is required to report whether prescribed cost accounts and cost records have been so made and maintained.</p> <p>(b) The auditor is not required to report on maintenance of cost accounts and cost records since cost auditor has already issued the cost audit report. In such situations, the auditor does not have any duty to report under CARO, 2020.</p> <p>(c) The auditor is required to examine the cost audit report as well as take into account any qualifications therein and report them under clause 3(vi) of CARO, 2020. However, his duty to report on maintenance of cost accounts and cost records does not exist anymore.</p> <p>(d) The auditor has a duty to report on cost accounts (or cost statements) only. The clause does not require the auditor to comment on maintenance of cost records (e.g. cost records relating to materials, labour, overheads) where specified by the Central Government.</p>
Q.4	<p>Considering the values of inventories arrived upon physical verification conducted by management vis-a-vis values reflected in its books of account, select the correct option for instance in the case study to be reported by the auditor on inventories under clause 3(ii)(a) of CARO, 2020?</p> <p>(a) Differences in all classes of inventories (raw material, work-in-progress, finished goods and stores and spares) should be reported irrespective of the materiality and the auditor should also comment on whether they have been properly dealt with in the books of account.</p> <p>(b) There is no instance to be reported in the given case since the difference between the total value of inventories as per books and physical verification is less than 10%.</p> <p>(c) To report differences in the value of work-in-progress, finished goods and stores and spares since the difference in each class of inventory is 10% or more (based on value after adjustments). The auditor should also comment on whether they have been properly dealt with in the books of account.</p> <p>(d) To report differences in the value of finished goods and stores and spares since the difference in each class of inventory is more than 10% (based on value as per books of accounts). The auditor should also comment on whether they have been properly dealt with in the books of account.</p>
Q.5	<p>Should the fraud described in para (E) of the case be reported by the auditor under clause 3(ix)(a) of CARO, 2020?</p> <p>(a) There is no duty to report since the amount involved is less than ₹ 1 crore.</p> <p>(b) It is a fraud on the company and the auditor should report the nature of fraud and amount involved. The duty to report the fraud under this clause is irrespective of the amount involved.</p> <p>(c) The requirement to report the fraud does not apply in the current situation since the fraud was not discovered by the auditor.</p>

	(d) The requirement to report the fraud does not apply in the current situation since the amount has been fully recovered during the year from the employees who committed the fraud.
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Answer – Integrated Case Study 2

Q. No.		Answer
1	(c)	All the four matters for which information has been provided in the fact pattern need to be reported.
2	(b)	It is the duty of the auditor to report whether company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment. This duty also applies to reporting on maintenance of records for Right-of-use assets and intangible assets. Further, auditor has to report on whether Property, Plant and Equipment have been physically verified by management at reasonable intervals. This duty to report on physical verification by management also extends to Right-of-use assets.
3	(a)	The auditor is required to report whether prescribed cost accounts and cost records have been so made and maintained.
4	(c)	To report differences in the value of work-in-progress, finished goods and stores and spares since the difference in each class of inventory is 10% or more (based on value after adjustments). The auditor should also comment on whether they have been properly dealt with in the books of account.
5	(b)	It is a fraud on the company and the auditor should report the nature of fraud and amount involved. The duty to report the fraud under this clause is irrespective of the amount involved.

Chapter 14A – Audit of Banks

Integrated Case Study - 3

CA. Subhadra is conducting statutory audit of a branch of FNB Bank. The branch is having deposits of ₹ 450 crore and advances of ₹300 crore respectively reflected in its financial statements as on 31st March 2024. While performing audit procedures, she noticed the following: -

(1) While reviewing advances of the branch, she came across the following particulars of two cash credit accounts: (₹ in crore)

Name of borrower	Sanctioned Limit	Value of primary security	Value of collateral security	Net worth of borrower	Net worth of guarantors
KT Fab	10.00	20.00	15.00	5.00	3.00
PM Decor	15.00	25.00	12.00	7.50	5.00

Following further information is also available in respect of above noted accounts: -

Information pertaining to KT Fab

(₹ in crore)		
As on	Drawing power	Outstanding balances
31.12.2023	9.00	9.61
31.01.2024	9.25	9.55
28.02.2024	9.50	9.60
31.03.2024	9.50	9.75

The outstanding balance in the account has remained more than ₹ 9.50 crore beginning from 31st December, 2023 till 31st March, 2024 on all days.

Information pertaining to PM Décor

(₹ in crore)		
As on	Drawing power	Outstanding balances
31.12.2023	12.00	12.50
31.01.2024	12.50	12.25
28.02.2024	12.50	12.40
31.03.2024	12.50	12.50

Both units are working and their financial position is satisfactory. The branch has classified both accounts as Standard Assets.

- (2) On reviewing "Statement of Accounts classified as NPA" as on 31.03.24, she finds that an education loan was granted to son of Mr. X, a customer of bank, for pursuing short duration technical higher studies abroad for ₹ 50.00 lakh sometime back repayable in 5 years. The loan was granted against security of residential house of Mr. X, valuing ₹ 60.00 lakh assessed by bank's empanelled valuer. However, the name of bank's empanelled valuer has now been removed due to certain irregularities. Later, value of residential house got reassessed from another valuer and he gave a report reflecting realisable value of residential house for ₹ 20.00 lakh. Meanwhile, the instalments in education loan account are overdue for 110 days as on 31st March, 2024. The account was classified as standard asset till last year i.e. 31st March, 2023.
- (3) While verifying deposits of the branch, she noticed that inoperative accounts for less than 10 years are to the tune of ₹ 5 crore reflected in the balance sheet of the branch. She plans to focus her audit procedures on this segment too. One of her team members has suggested the following audit procedures in this regard:
- Verifying whether there exists a system of informing customers on accounts turning inoperative.
 - Identification of cases where there is significant reduction in balances as compared to last year.
 - Testing debits in inoperative accounts.
 - Verifying auto activation of inoperative accounts.
- (4) While gathering information to be included in LFAR, she comes across some cases of advance accounts which became non-performing within a relatively short span of time. The details of few such identified accounts are as under:

Account name	Sanctioned amount (₹ in crore)	Nature of facility	Date of first sanction	Date of renewal
ABC Industries	1.00	Cash credit	15/05/23	Not applicable
XY Pvt. Ltd.	0.50	Cash credit	01/07/23	Not applicable
SK & Sons	1.50	Cash credit	04/04/22	04/04/23
DK Creations	0.75	Term loan	01/10/23	Not applicable

- (5) The branch also sends substantial number of Inland outward bills for collection. The bank has a system under which account of customer on whose behalf bill has been sent for collection is credited only after the bill has been actually collected from the drawee either by the bank itself or through its agents. One of her team members has jotted following audit procedures for Inland outward bills sent for collection:

- Verification of outward bills for collection as on closing date.
- Verification of accrual of commission income in respect of bills outstanding as on closing date.
- Verification of accrual of charges in account of customer on whose behalf bill was sent for recovery where bill has been returned unpaid.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

[MTP-Sep. 23]

Q.1	<p>Keeping in view information stated in respect of two borrower accounts at para (1) of case scenario, which of the following statement is correct?</p>
	<p>(a) The classification made by branch is not proper. Both accounts should be classified as non-performing assets.</p> <p>(b) The classification made by branch is not proper. Borrower account of KT Fab should be classified as Standard asset. However, borrower account of PM Décor should be classified as non-performing asset.</p> <p>(c) The classification made by branch is not proper. Borrower account of KT Fab should be classified as non-performing asset. However, borrower account of PM Décor should be classified as Standard asset.</p> <p>(d) The classification made by branch is proper.</p>
Q.2	<p>Considering issue relating to education loan described in para (1) of case scenario, how should it be classified in books of branch as on 31st March, 2024?</p>
	<p>(a) Sub-standard asset.</p> <p>(b) Doubtful asset.</p> <p>(c) SMA.</p> <p>(d) Loss asset.</p>
Q.3	<p>As discussed in para (3) of case scenario, one of team members has suggested certain audit procedures described in case scenario for verification of inoperative accounts. Which of audit procedure(s)/ combination of procedures are relevant in such a situation?</p>
	<p>(a) Identification of cases where there is significant reduction in balances as compared to last year, testing debits in inoperative accounts and verifying auto-activation of inoperative accounts.</p> <p>(b) Verifying whether there exists a system of informing customers on account turning inoperative, identification of cases where there is significant reduction in balances as compared to last year and verifying auto activation of inoperative accounts.</p> <p>(c) Verifying whether there exists a system of informing customers on account turning inoperative, testing debits in inoperative accounts and verifying auto activation of inoperative accounts.</p> <p>(d) Verifying whether there exists a system of informing customers on account turning inoperative, identification of cases where there is significant reduction in balances as compared to last year and testing debits in inoperative accounts.</p>
Q.4	<p>Quick mortality cases are required to be stated in LFAR by statutory branch auditor. With reference to the particulars in para (4) above, which of the following statement is correct?</p>
	<p>(a) All the four cases reflected in the table in para (4) are quick mortality cases. Quick mortality cases are indicative of shortcomings in credit appraisal.</p> <p>(b) Only the case of DK creations is in nature of quick mortality case. Quick mortality cases are indicative of shortcomings in credit appraisal.</p> <p>(c) Cases of ABC Industries, XY Pvt Ltd and DK creations are in nature of quick mortality cases. Quick mortality cases are indicative of shortcomings in credit appraisal.</p> <p>(d) Cases of XY Pvt Ltd and DK creations are in nature of quick mortality cases. Quick mortality cases are indicative of shortcomings in credit disbursement.</p>

Q.5	<p>One of her team members has planned certain audit procedures described in case scenario at para (5) for verification of Inland outward bills for collection. Which of the following audit procedure(s)/combination of procedures are likely to be relevant in such situation?</p> <p>(a) To verify bills for collection on closing date.</p> <p>(b) To verify bills for collection on closing date and verification of accrual of commission in respect of bills outstanding as on closing date.</p> <p>(c) To verify accrual of charges in account of customer on whose behalf bill was sent for recovery where bill has been returned unpaid.</p> <p>(d) To verify accrual of commission in respect of bills outstanding as on closing date and verification of accrual of charges in the account of customer on whose behalf bill was sent for recovery where bill has been returned unpaid.</p>
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Answer – Integrated Case Study 3

Q. No.	Answer
1	(c) The classification made by branch is not proper. Borrower account of KT Fab should be classified as non-performing asset. However, borrower account of PM Décor should be classified as Standard asset.
2	(b) Doubtful asset.
3	(d) Verifying whether there exists a system of informing customers on account turning inoperative, identification of cases where there is significant reduction in balances as compared to last year and testing debits in inoperative accounts.
4	(c) Cases of ABC Industries, XY Pvt Ltd and DK creations are in nature of quick mortality cases. Quick mortality cases are indicative of shortcomings in credit appraisal.
5	(c) To verify accrual of charges in account of customer on whose behalf bill was sent for recovery where bill has been returned unpaid.

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Integrated Case Study - 4

M/s JKL & Associates, Chartered Accountants were acting as the statutory auditors of M/s IBS Bank Limited. During the statutory audit for the relevant financial year, the following observations were made:

- Interest income included the following:
 - (a) ₹ 5 lakh relating to a short-term crop loan where instalment was overdue for one crop season.
 - (b) ₹ 7 lakh relating to an advance (guaranteed equally by Government of India & Government of Tamil Nadu) where the instalment was due for more than six months.
- A 25 month old NPA account worth ₹ 43 lakh (net book value) was sold to an asset reconstruction company for ₹ 45 lakh. The profit from the above transaction was taken to the P&L account. The above NPA was sold 'without recourse' and at cash basis. The auditors noticed a discrepancy in this transaction and hence decided to report the same

After completing the bank audit, JKL & Associates agreed to take up the following management consultancy and other services for one of the start-up company based in Noida:

- (I) Setting up executive incentive plan and wage incentive plan.
- (II) Price-fixation and other management decision making.

(III) Conduct a periodical audit and advisor for tax matters.

Mr. K, one of the partners of the firm felt that providing the above services could result in professional misconduct. Hence, he resigned from the partnership and became a sole practitioner. One of the clients of JKL & associates came to know about the issue and they approached Mr. K to conduct the statutory audit for the financial year. Mr. K took up the assignment without informing the previous firm. Annoyed by this, Mr. J filed a complaint to ICAI regarding the act of Mr. K. After enquiry, it was decided that Mr. K was guilty of professional misconduct.

After this incident, Mr. K also decided to file a complaint against Mr. J. When he was thinking about a reason for the same, he remembered that Mr. J had entered into an agreement with two of his articled clerks to pay stipend on an annual basis, while others were paid on monthly basis. Realising that this act is in violation of Regulation 48 of the Act, he filed a complaint to ICAI. After enquiry, it was found that Mr. J was guilty of professional misconduct.

On the basis of the above-mentioned facts, you are required to choose the most appropriate answer for the following MCQs:

[ICAI-Practice Question]

1	<p>From the above facts and details, what is the correct amount of interest which the bank should account in its financial statements?</p> <p>(a) Nil. (b) ₹ 8.5 lakh. (c) ₹ 5 lakh. (d) ₹ 3.5 lakh.</p>
2	<p>What could be the possible amount classified as NPA relating to the accounts with respect to observation regarding the inclusion of interest income given below:</p> <p>(i) ₹ 5 lakh relating to a short-term crop loan where instalment was overdue for one crop season. (ii) ₹ 7 lakh relating to an advance (guaranteed equally by Government of India & Government of Tamil Nadu) where the instalment was due for more than six months.</p> <p>(a) ₹ 12 lakh. (b) ₹ 8.5 lakh. (c) ₹ 7 lakh. (d) ₹ 3.5 lakh.</p>
3	<p>In NPA, sale to asset reconstruction company, what discrepancy auditor might have noticed:</p> <p>(a) The NPA had not completed 30 months. (b) Sale was made 'without recourse'. (c) Sale was made for cash basis. (d) The profit of ₹ 2 lakh was taken to P&L account.</p>

Answer – Integrated Case Study 4

Q. No.	Answer	
1	(c)	₹ 5 lakh.
2	(d)	₹ 3.5 lakh.
3	(d)	The profit of ₹ 2 lakh was taken to P&L account.

Misc. Topics

Integrated Case Study - 5

Rainbow Non-Bank Limited, a “Non-Systemically Important Non-Deposit Taking Non-Banking Financial Company,” was operating appropriately till the start of the COVID-19 pandemic. Due to unforeseen conditions during the pandemic and after that, the operating revenue of the NBFC started decreasing. Following is the position of Net Owned Funds of the company during the last 4 financial years:

Financial Year	Net Owned Funds
FY 20-21	₹ 12 crore
FY 21-22	₹ 5 crore
FY 22-23	₹ 3 crore
FY 23-24	₹ 2.5 crore

Rainbow Non-Bank Limited appointed Tirthankara & Company as their statutory auditor for FY 2023-24. Rainbow Non-Bank was involved in re-financing of accounts payables of other companies (i.e., paying to accounts payables on behalf of the company on the due date and allowing additional credit period by charging interest).

To test for understatement in existence or valuation of accounts payable, Mr. Abhinandan (Engagement Partner) decided to test recorded & refinanced accounts payables on a sample basis. He also decided to verify refinanced accounts payable against signed contracts.

Mr. Abhinandan did not identify any misstatements.

While performing audit procedures in the month of March 2024 itself, it was noticed by Mr. Abhinandan that Senior Sales Manager from Rainbow Non-Bank agreed to refinance the accounts payables of Opal Stones India Limited, but on the due date, he issued payment to his personal account instead of issuing payments to Accounts Payables of Opals Stones India Limited. The matter was flagged by him to audit committee and amount was subsequently recovered. Due to this Opal Stones had to pay an additional amount of ₹ 4 crore over and above amount of accounts payables of ₹ 25 crore embezzled by the Senior Sales Manager. As Opal Stones had to shell out extra funds due to above, it was proposing to file a suit against the company. However, negotiations were still going on between two companies to settle the matter. There was no disclosure in financial statements regarding these negotiations.

No other observation was identified by Mr. Abhinandan. He is considering to express an unmodified opinion in above situation. He has also approached EQCR to review working papers and documentation.

On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs: [RTP-Nov. 23]

- | | |
|---|--|
| 1 | <p>While reviewing working papers of Mr. Abhinandan, the Engagement Quality Control Reviewer (EQCR) identified that the audit procedure followed to test for understatement in existence or valuation of accounts payable refinanced is not relevant. However, Mr. Abhinandan did not understand the comments provided by his EQCR. Kindly guide Mr. Abhinandan with respect to the “relevance of the audit procedure” by selecting the appropriate option from below:</p> <p>(a) Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. In the current case, testing accounts payable by following stated audit procedure will be relevant for testing overstatement inexistence or valuation of accounts payable and not their understatement.</p> |
|---|--|

	<p>(b) Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. In the current case, testing accounts payable will give comfort on completeness and valuation but not on existence.</p> <p>(c) The relevance of the 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.</p> <p>(d) The relevance of audit evidence is increased when it is obtained from independent sources outside the entity.</p>
2	<p>During the review of Mr. Abhinandan's working papers, the External Conformity and Quality Review (EQCR) observed that Rainbow Non-Bank Limited's performance was subpar, with the Net Owned Funds (NOF) standing at ₹ 2.5 crore at the close of FY 23-24. The EQCR believed that Mr. Abhinandan was expected to include the NOF in the auditor's certificate for the year-end. However, Mr. Abhinandan disagreed with the same. Can you please provide guidance on the accurate reporting obligation in the current case.</p> <p>(a) Every NBFC is required to submit a certificate from the Statutory Auditor that it is engaged in business of NBFC requiring it to hold certificate of registration and it is eligible to hold it. Certificate with reference to the position of the company as of the end of the financial year ended March 31 is required to be submitted.</p> <p>(b) Non-banking financial company whose NOF falls below ₹ 200 Lakh shall submit a certificate from its Statutory Auditor.</p> <p>(c) A certificate from the Statutory Auditor with reference to the position of the company as of the end of the financial year ended March 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision. However, the same is not mandatory.</p> <p>(d) Only for NBFC - MFI, a certificate from the Statutory Auditor with reference to the position of the company as of the end of the financial year ended March 31 should be submitted to the Regional Office of the Department of Non-Banking Supervision.</p>
3	<p>Regarding the issue involving the embezzlement by the Senior Sales Manager, what is the most appropriate compliance action for Mr. Abhinandan under the provisions of the Companies Act, 2013? Please select the most suitable option from the choices below:</p> <p>(a) As per Sec. 92 of the Companies Act, 2013, every auditor shall prepare a return in the prescribed form containing the particulars as they stood on the close of the financial year regarding penalty or punishment imposed on the company, its Directors or officers and details of compounding of offences and appeals made against such penalty or punishment.</p> <p>(b) As per Sec. 143(12) of the Companies Act, 2013 read with Rule 13, 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.</p> <p>(c) As per Sec. 143(12) of the Companies Act, 2013 read with Rule 13, 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 ₹ 10 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.</p>

	<p>(d) As per Sec. 92 of the Companies Act, 2013, every auditor shall prepare a return in the prescribed form containing the particulars as they stood on the close of the financial year regarding penalty or punishment imposed on the company, its Directors or officers, which involves or is expected to involve individually an amount of ₹ 10 crore or above, and details of compounding of offences and appeals made against such penalty or punishment.</p>
4	<p>Considering the overall materiality of ₹ 2 crore, EQCR believes that Mr. Abhinandan should not issue an unmodified opinion. Mr. Abhinandan, however, argues that he has not identified any material misstatement. To guide Mr. Abhinandan appropriately, the following option is the most suitable:</p> <p>(a) If the auditor has expressed an unmodified opinion on the financial statements, then the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion and the effects thereof.</p> <p>(b) If there is a material misstatement in the financial statements that relate to the non-disclosure of information that should be disclosed, then the auditor shall discuss the non-disclosure with those charged with governance, and where the impact of non-disclosure is material but not pervasive, then the auditor should issue a qualified opinion.</p> <p>(c) When evaluating the outcome of litigation, the Auditor should record in the audit report the interests and relationships of management that may create threats in the litigation and any applicable safeguards to save the company from outcomes of litigation, whether legal or not.</p> <p>(d) If the auditor has expressed an unmodified opinion along with the “Emphasis of Matter” Paragraph, then the auditor shall describe in the “Basis for Emphasis of Matter” section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion and the effects thereof.</p>
5	<p>On noticing the issue, Mr. Abhinandan reported the fraud to Audit Committee within two days of his knowledge of the fraud, seeking their reply or observations within 45 days. However, neither the audit committee nor management replied to the auditor till the 45th day. Kindly guide what the auditor is expected to do in the case when he has not received any reply from the audit committee or management.</p> <p>(a) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall wait for the next 45 days, and he shall send a reminder to Audit Committee and Management to reply on the matter reported by him to them.</p> <p>(b) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall report the matter to shareholders and should seek their reply on observations within the next thirty days.</p> <p>(c) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five 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.</p> <p>(d) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the CFO 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.</p>

Answer – Integrated Case Study 5

Q. No.	Answer	
1	(a)	Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. In the current case, testing accounts payable by following stated audit procedure will be relevant for testing overstatement inexistence or valuation of accounts payable and not their understatement.
2	(a)	Every NBFC is required to submit a certificate from the Statutory Auditor that it is engaged in business of NBFC requiring it to hold certificate of registration and it is eligible to hold it. Certificate with reference to the position of the company as of the end of the financial year ended March 31 is required to be submitted.
3	(b)	As per Sec. 143(12) of the Companies Act, 2013 read with Rule 13, 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.
4	(b)	If there is a material misstatement in the financial statements that relate to the non-disclosure of information that should be disclosed, then the auditor shall discuss the non-disclosure with those charged with governance, and where the impact of non-disclosure is material but not pervasive, then the auditor should issue a qualified opinion.
5	(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.

Integrated Case Study - 6

MINSAN Ltd., an unlisted company in South India, is engaged in the business of spice oil extraction. Total paid up capital of the company is ₹ 9 crore. Details of annual turnover and profit of the company for the last 3 years are given below:

Year ended	Turnover (₹ in crore)	Profit (loss) before tax (₹ in crore)
31-03-2021	527.21 (Audited)	50.16
31-03-2022	301.37 (Audited)	01.25
31-03-2023	104.13 (provisional)	(10.25)

The company is using conventional method for extraction of oil from spices. This requires more human intervention and hence, cost of production is high as compared to innovative method used by other new companies. Though the company had significant growth in the past years, it has not done well over the last two financial years due to competition.

A new competitor viz, Natural Extracts Ltd, had come in the market during the year 2021 and by the end of March, 2022, they captured around 75% of market share by offering the product at a reduced price. They use new machinery which allows whole range of automated extraction method, thus, minimizing manual steps and reducing cost of labour.

In order to reduce cost of production and thereby re-capture the market, the management of MINSAN Ltd. has planned to erect a new plant with an automatic machine. The estimated cost of plant & machinery is ₹ 90 lakh. The company approached SA Bank Ltd. for a term loan of ₹ 80 lakh which would be repaid in 5 years. On 28-12-2022, the bank had sanctioned the loan; and disbursed ₹ 40 lakh till 31 March, 2023.

MINSAN Ltd. has appointed M/s Check & Check, Chartered Accountants, as auditors of the company at its AGM held on 18-09-2022 for a period of 5 years. As agreed, the audit team commenced their audit work for the year 2020-2021 in February, and completed the work by the end of May, 2023. The audit team submitted following findings to the engagement partner:

- PX Ltd., one of the material suppliers, filed a case against the company on 12-09-2022 for a compensation of ₹ 3 crore.
- Company has made an estimate for allowance of debtors @5%.
- 70% of the value of inventory was only covered in physical verification during the year 2020-21 due to outbreak of Novel Corona Virus (COVID-19) and subsequent lockdown thereof.
- Company got a show cause notice from State Pollution Control Board for the contravention of the provisions of Hazardous and waste Management Rule.

Three incidences of fraud noticed (total ₹ 1.02 crore)- fraud committed by the Purchase manager ₹ 85 lakh, by Accounts manager ₹ 15 lakh and by a cashier ₹ 2 lakh.

On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs:

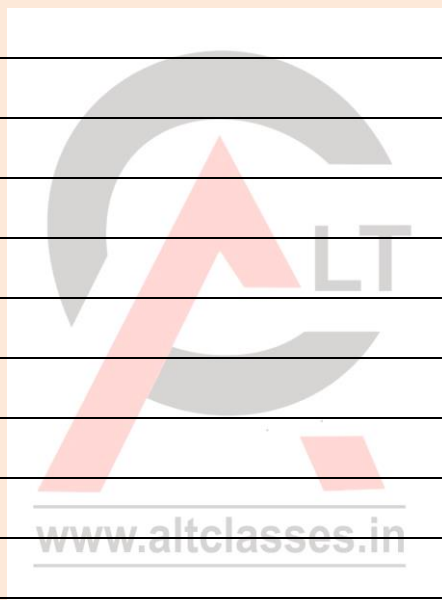
[ICAI-Practice Question]

1	<p>Though the company had significant growth in the past years, it has not done well over the last two financial years. As per SA 570, there are certain events or conditions that individually or collectively may cast significant doubt about the going concern assumptions. In order to assess whether MINSAN Ltd is a going concern or not, which of the following audit procedures should NOT be performed?</p> <p>(a) Analysis and discuss with the management of the company to find out whether installation of new plant and machinery would enable the company to reduce cost of production.</p> <p>(b) Inquire the company's legal counsel regarding existence of legal litigation and claim against the company, reasonableness of management assessments of their outcome and estimate of their financial implication.</p> <p>(c) Evaluating management's future plan and strategy to increase market share of product.</p> <p>(d) Analysis and discussion of the company's cashflow and profit of the previous years with the projected accounts.</p>
2	<p>Company has made an estimate for allowance of debtors @5%. Some financial statement items cannot be measured precisely but can only be estimated. The nature and reliability of information available to management to support the making of an accounting estimate varies widely, which thereby affects the degree of estimating uncertainty associated with accounting estimates. Please advise which among the following may have higher estimate uncertainty and higher risk as per SA 540?</p> <p>(a) Judgments about the outcome of pending litigation with PX Ltd. against the company.</p> <p>(b) Estimates made for inventory obsolescence that are frequently made and updated.</p> <p>(c) A model used to measure the accounting estimates is well known and the assumptions to the model are observable in market place.</p> <p>(d) Accounting estimate made for allowance for doubtful debts where the result of the auditors review of similar accounting estimates made in the prior period financial statements do not indicate any substantial difference between the original accounting estimate and the actual outcome.</p>

3	<p>Company got a show cause notice from State Pollution Control Board. As per SA 250, the auditor shall perform the audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements. As the audit team of the company became aware of information concerning an instance of non-compliance with law, what would NOT be the audit procedure to be performed?</p> <p>(a) Monitoring legal requirement and compliance with code of conduct and ensuring that operating procedures are designed to assist in the prevention of non-compliance with law and regulation and report accordingly.</p> <p>(b) Evaluate the implication of non-compliance in relation to other aspects of audit including risk assessment and reliability of written representation and take appropriate action.</p> <p>(c) Discuss the matter with management and if they do not provide sufficient information; and if the effect of non-compliance seems to be material, legal advice may be obtained.</p> <p>(d) Understand the nature of the act and circumstances in which it has occurred and obtain further information to evaluate the possible effect on the financial statement.</p>
4	<p>The company in the notes accompanying its financial statements disclosed the existence of suit filed against the company with full details. Based on the audit evidence obtained, it is necessary to draw user's attention to the matter presented in the financial statement by way of clear additional communication as there is an uncertainty relating to the future outcome of the litigation. In this situation, which of the following reporting option would be correct if auditor is satisfied with the conclusions reached by the management and this matter is fundamental to the reader of financial statements?</p> <p>(a) Include an Emphasis of Matter paragraph in Auditors report having a clear reference to the matter being emphasized and issue a qualified opinion.</p> <p>(b) Include in the Basis for Adverse opinion paragraph and issue an adverse opinion having a clear reference to the matter referred in the notes on accounts.</p> <p>(c) Include in the Basis for Disclaimer of opinion paragraph having a clear reference to the matter and issue a disclaimer opinion.</p> <p>(d) Include an Emphasis of Matter Paragraph in Auditors report having a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statement.</p>

Answer – Integrated Case Study 6		
Q. No.	Answer	
1	(d)	Analysis and discussion of the company's cashflow and profit of the previous years with the projected accounts.
2	(a)	Judgments about the outcome of pending litigation with PX Ltd. against the company.
3	(a)	Monitoring legal requirement and compliance with code of conduct and ensuring that operating procedures are designed to assist in the prevention of non-compliance with law and regulation and report accordingly.
4	(d)	Include an Emphasis of Matter Paragraph in Auditors report having a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statement.

NOTES



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