

CA INTERMEDIATE

Auditing & Ethics Descriptive Question Bank

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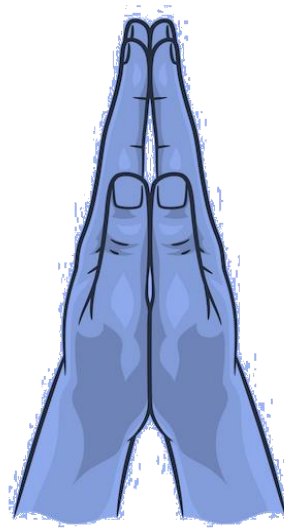
First Edition June 2024

**Relevant For September 2024
and Onwards**

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CA Deepika Rathi



DEDICATED

To My Parents

for raising me to believe that anything was possible

First Edition 2024

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Valuable suggestions and constructive feedback from learners is welcome and would be gratefully acknowledge please feel free to e-mail your feedback, problems or suggestions to us on drathi31@gmail.com.

Happy Learning and all the best!!

Chapter- 1: Nature, Objective and Scope of Audit

Q-1: M Motors Ltd is a leading Indian automobile manufacturer with many offerings across commercial, passenger and electric vehicles. The Company is pioneering India's electric vehicle transition and enjoys considerable advantage in one of the fastest growing automotive markets. GR & Associates have been appointed as its statutory auditors for financial year 2022-23. J and K are newly appointed audit assistants in the firm and are part of engagement team constituted for purpose of audit of M Motors Ltd. However, they are confused about what such an audit tends to achieve. They perceive audit as a guarantee against possible errors or frauds in financial statements. Do you agree with perception of both the assistants? In this context, outline objectives of an independent audit conducted in accordance with Standards on Auditing. [RTP May 2024]

Ans-1: In conducting audit of financial statements, objectives of auditor in accordance with SA-200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are:

- a. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework and
- b. To report on the financial statements and communicate as required by the SAs, in accordance with the auditor's findings.

An analysis of above brings out following points clearly:-

1. Auditor's objective is to obtain a reasonable assurance whether financial statements as a whole are free from material misstatement whether due to fraud or error.

Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance.

Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On the basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance.

2. Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain reasonable assurance whether financial statements as a whole are free from material misstatements caused by fraud or error. He has to see effect of misstatements on financial statements as a whole, in totality.
3. Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
4. The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on Auditing.

Therefore, perception of both assistants is not proper. Auditor of financial statements does not seek to provide guarantee that financial statements are free from material misstatements caused by frauds or errors. He obtains reasonable assurance.

Q-2: Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples. [RTP May 2024]

Ans-2: Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information". Standards on auditing apply in "audit" of historical financial information which is a reasonable assurance engagement whereas Standards on Review Engagements apply in "review" of historical financial information which is a limited assurance engagement only.

"Historical financial information means" information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting

system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

"Audit" and "review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement.

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are:

- i. SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- ii. SA 230 Audit Documentation
- iii. SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- iv. SA 500 Audit Evidence
- v. Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

- i. SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- ii. SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

Q-3: "An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon."

Ans-3: An Audit is independent examination of Financial Information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

This definition has the following implications:

- a. Audit is independent examination.
- b. Examination is of financial information when the objective is to express an opinion.
- c. Requirement of audit applies in case of every entity, whether profit oriented or not (Commercial entities or NGOs), whatever is the business size of entity (Small Size entity or large size entity), whatever is the legal form of the entity (proprietor, partnership or company).

Q-4: The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing.

Ans-4: Auditor engaged to perform the task of performing audit need to ensure the following:

- The accounts have been drawn up with reference to entries in the books of account
- The entries in the books of account are adequately supported by sufficient and appropriate evidence
- None of the entries in the books of account has been omitted in the process of compilation
- The information conveyed by the statements is clear and unambiguous
- The financial statement amounts are properly classified, described and disclosed in conformity with accounting standards and
- The statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities

Q-5: RAG is proprietorship firm engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of ₹ 30 crores. It has also availed cash credit limit of ₹ 5 crores from Canara Bank. In the year 2021-22, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches a CA about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts

audited.

Ans-5: Benefits of the Audit are

- Audited accounts provide high quality information. It gives confidence to users that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally
- In case of companies, shareholders may or may not be involved in daily affairs of the company. The financial statements are prepared by management consisting of directors. As shareholders are owners of the company, they need an independent mechanism so that financial information is qualitative and reliable. Hence, their interest is safeguarded by an audit.
- An audit acts as a moral check on employees from committing frauds for the fear of being discovered by audit.
- Audited financial statements are helpful to government authorities for determining tax liabilities.
- Audited financial statements can be relied upon by lenders, bankers for making their credit decisions *i.e.* whether to lend or not to lend to a particular entity.
- An audit may also detect fraud or error or both.
- An audit reviews existence and operations of various controls operating in any entity. Hence, it is useful at pointing out deficiencies.

Q-6: The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Explain.

Ans-6: The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error.

These fundamental limitations arise due to the following factors: -

1. **Nature of financial reporting:** Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors. One of the premises for conducting an

audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations. Management of a company has devised a control that all purchase bills should reflect stamp and signatures of an authorised person in "Goods Receiving Section" of the company stating the date and time of receiving goods in premises. It is an example of internal control devised by the company to ensure that only those purchase bills are produced for payment for which goods have been actually received.

2. **Nature of Audit Procedures:** The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are *practical and legal* limitations on ability of auditor to obtain audit evidence. Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of *legal limitation* on auditor's ability to obtain audit evidence. The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine. An auditor is not an expert in authentication of documents. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents. It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.
3. **Not in nature of investigation:** Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.
4. **Timeliness of financial reporting and decrease in relevance of information over time:** The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it.
5. **Future Events:** Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business.

The business may cease to exist in future due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

Q-7: Standards on Auditing (SAs) apply in “audit of historical financial information” whereas Standards on Review Engagements (SREs) apply in “review of historical financial information.” Explain in detail giving examples.

Ans-7: Standard on Auditing (SAs):

- ✓ Standards on Auditing apply in the context of an audit of financial statements by an independent auditor. Standards on Auditing apply in audit of historical information
- ✓ These establish high quality benchmarks and are followed by auditors in conducting audit of financial statements.
- ✓ Standards on Auditing have been issued on wide spectrum of issues in the field of auditing ranging from overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit sampling, audit evidence and forming an opinion and reporting on financial statements.
- ✓ These cover all significant aspects of audit of financial statements.
- ✓ Examples of Standards on Auditing are:
 - SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing
 - SA 230 Audit Documentation

Standard on Review Engagements (SREs)

- ✓ Standards on review engagements apply in the context of review of financial statements.
- ✓ Review is a limited assurance engagement and it provides assurance which is lower than that provided by audit.
- ✓ It is due to the fact that review involves fewer procedures as compared to audit.
- ✓ Since a review also provides assurance to users, it also involves obtaining sufficient appropriate evidence.
- ✓ Examples of Standards on Review engagements are :
 - SRE 2400 (Revised) Engagements to Review Historical Financial Statements
 - SRE 2410 Review of Interim Financial Information Performed by the

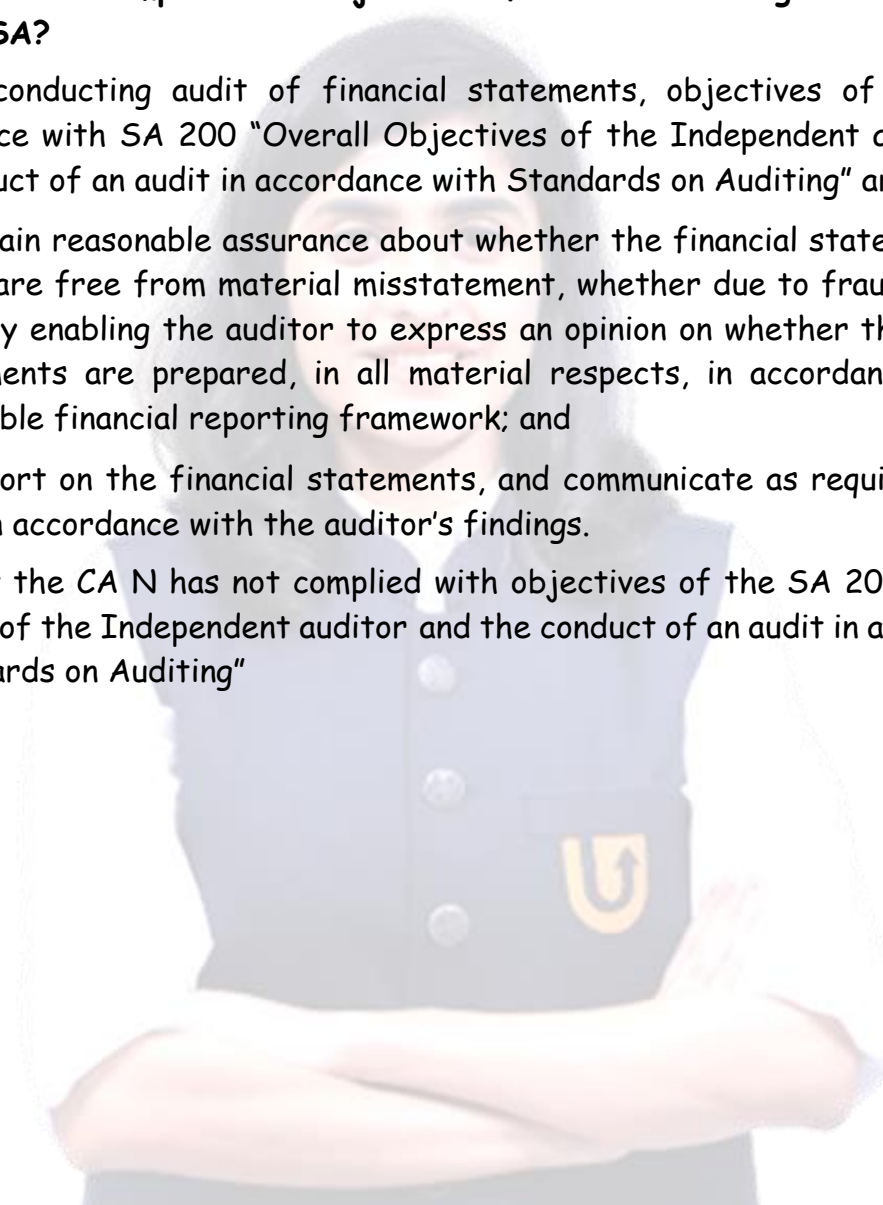
Independent Auditor of the Entity.

Q-8: CA N is the auditor of SR Ltd. The auditor expressed his opinion on the financial statements without ascertaining as to whether the financial statements as a whole were free from material misstatements or not. In your opinion, whether CA N has complied with objectives of audit considering the applicability of relevant SA?

Ans-8: In conducting audit of financial statements, objectives of auditor in accordance with SA 200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are :-

- a. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- b. To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Accordingly the CA N has not complied with objectives of the SA 200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing"



Chapter-2: Audit Strategy, Audit Planning and Audit Programme

Q-1: Preliminary engagement activities include certain activities to be performed by an auditor while planning an audit. Discuss such activities briefly. How performing such activities assists an auditor? [RTP May 2024]

Ans-1: Preliminary engagement activities

Preliminary engagement activities include following activities: -

- A. Performing procedures regarding the continuance of the client relationship
- B. Evaluating compliance with ethical requirements, including independence
- C. Establishing an understanding of terms of engagement

Performing preliminary engagement activities assists auditor in identifying and evaluating events or circumstances that may affect auditor's ability to plan and perform audit engagement.

Q-2: The assistant of CA K is assigned responsibility of drafting "audit programme" relating to purchases appearing in financial statements of "Broad Industries", a partnership firm. The said firm is a GST registered tax payer and is engaged in manufacturing of packing boxes from a special type of paper taxable under GST. Help him by drafting a sample audit programme for purchases. [RTP May 2024]

Ans-2: Sample audit programme pertaining to purchases

Name of Concern : Broad Industries
 Financial Year : 20XX-XX
 Prepared by : Name of person with date
 Reviewed by : Name of person with date
 Approved by : Name of person with date

S.no.	Nature of Procedure	Extent of	Basis of	Done by
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		Check	Sample	
(a)	Vouch few purchase invoices of paper from purchase records of concern.			
(b)	Trace these invoices into account books of concern.			
(c)	Verify few purchase invoices of paper on GST portal.			
(d)	Trace few purchase invoices of paper in stock records to ensure that these have been added to stocks of raw material.			

Q-3: Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The process of establishing the overall. (RTP May 2020 & Nov 2018)

Or

The engagement partner of AST AND ASSOCIATES, firm of Chartered Accountants appointed as auditor of Fabric India Ltd is considering as to management of key resources to be employed to conduct audit. Discuss how overall audit strategy would assist the auditor. (MTP March 2018, Oct 2018)

Ans-3: The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

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

1. The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters;
2. The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas
3. When these resources are to be deployed, such as whether at an interim audit stage or at key cut- off dates; and
4. How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (**for example, on-site or off-site**), and whether to complete engagement quality control reviews.

In establishing the overall audit strategy, the auditor shall

- Ascertain the nature, timing and extent of resources necessary to perform the engagement.
- The selection of engagement team and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement.
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.

Q-4: The auditor shall document the overall audit strategy, the audit plan, and any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. Explain. (MTP 2018, RTP Nov 2020 & Nov 2018)

Ans-4: The auditor shall document:

- a. the overall audit strategy
- b. the audit plan and
- c. any significant changes made during the audit engagement to the overall audit

strategy or the audit plan, and the reasons for such changes.

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

For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

For instance-

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

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

Q-5: Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the

completion of the previous audit and continues until the completion of the current audit engagement. (MTP Oct 2018)

Ans-5: "Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as: -

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

Therefore, planning includes consideration of matters such as obtaining knowledge about legal framework in which entity is operating.

Planning also includes need to consider determination of material or significant matters. It also involves considering whether experts need to be involved taking into account complexity of business. Further, it also involves considering need to perform risk assessment procedures for identifying and assessing risks of material misstatement.

Q-6: The establishment of the overall audit strategy and the detailed audit plan are closely inter-related. Explain (MTP Marks March 2019)

Ans-6: Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are

closely inter-related since changes in one may result in consequential changes to the other.

Q-7: Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes the need to consider certain matters prior to the auditor's identification and assessment of the risks of material misstatement. Explain clearly stating those matters also. (RTP -MAY 2021)

Ans-7: In the context of recurring audits, as per SA-300, "Planning an Audit of Financial Statements", Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

- i. The analytical procedures to be applied as risk assessment procedures.
- ii. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
- iii. The determination of materiality.
- iv. The involvement of experts.
- v. The performance of other risk assessment procedures.

Q-8: The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. Explain the factors due to which above varies. (MTP May 2020, RTP Nov 2020)

Ans-8: The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement
4. The capabilities and competence of the individual team members performing the audit work.

Q-9: In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement. (MTP Nov 2021 & April 2023, RTP Nov2023, Nov 2019)

Ans-9: In establishing the overall audit strategy, auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the reporting objectives of the engagement are :

- The entity's timetable for reporting
- Organization of meetings to discuss of nature, timing and extent of audit work with management
- Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report
- Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.

Q-10: Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways. Explain clearly those ways. (RTP -NOV 2021)

Ans-10: Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

- Helping the auditor to devote appropriate attention to important areas of the audit.
- Helping the auditor identify and resolve potential problems on a timely basis.
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
- Facilitating the direction and supervision of engagement team members and the review of their work.
- Assisting, where applicable, in coordination of work done by auditors of components and experts.

Q-11: Engagement Partner CA Hitesh Kapur of Kapur and Associates wanted to develop an audit plan of Sampoorna Fabrics Ltd. Discuss the matters to be described in such an audit plan. (RTP -MAY 2022)

Ans-11: The auditor shall develop an audit plan that shall include a description of:

- i. The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- ii. The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".
- iii. Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team

members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

Planning of the auditor's risk assessment procedures occurs early in the audit process.

However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

Q-12: Explain what do you mean by documentation of audit plan. Discuss the purpose served by it and also elaborate the tools used by the auditor to reflect the particular engagement circumstances. (RTP -NOV 2022)

Ans-12: The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.

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

Q-13: XYZ & associates are appointed as the statutory auditors of Fisco Ltd. for the FY 2021 -22. While constructing the audit programme, the engagement partner, CA X, should keep in mind various points. List such points. (MTP 4 Marks Oct2022)

Or

Arpan Hospitals Ltd having Gross Professional Charges of ` 50 crores are engaged in providing healthcare services. STP & Co., a firm of auditors is appointed as its auditors.

Advise what special points to be kept in mind for the purpose of construction of an Audit programmer Explain. (RTP May 2018 & Nov 2022, May 2019)

Ans-13: For the purpose of audit programme construction, CA X should keep in mind the following points:

1. Stay within the scope and limitation of the assignment.
2. Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
3. Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
4. Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
5. Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.
6. Consider all possibilities of error.
7. Co-ordinate the procedures to be applied to related items.

Q-14: As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan. Explain (RTP Nov '19 & Nov '18, PYP 2 Marks May 22)

Ans-14: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls.

Q-15: Plans should be further developed and revised as necessary during the course of the audit. Explain. (RTP May 2020)

Ans-15: Plans should be further developed and revised as necessary during the course of the audit.

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

Q-16: Evolving one audit programme applicable to all business under all circumstances is not practicable. Explain clearly stating in detail the meaning of audit programmer. (RTP Nov 2020)

Ans-16: suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programmer applicable to all business under all circumstances is not practicable. However, it becomes a necessity to specify in detail in the audit programmer the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

It is desirable that in respect of each audit and more particularly for bigger audits an audit programmer should be drawn up. Audit programmer is a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions discernible in the statements of account produced for audit or on the basis of an appraisal of the accounting records of the client.

Definition: An audit programme consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements.

In other words, an audit programmer is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

Q-17: Without adequate knowledge of client's business, a proper audit is not possible. It is one of the important principles in developing an overall audit plan.

Explain in context with relevant SA, knowledge to be obtained by the auditor in establishing overall plan. Also explain how such an understanding would be helpful to the auditor. (RTP May 2021)

Ans-17: Without adequate knowledge of client's business, a proper audit is not possible. It is one of the important principles in developing an overall audit plan. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the following:

- a. Relevant industry, regulatory and other external factors including the applicable financial reporting framework.
- b. the nature of the entity, including:
 - i. its operations;
 - ii. its ownership and governance structures;
 - iii. the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 - iv. the way that the entity is structured and how it is financed;

to enable the auditor to understand the classes of transactions, account balances and disclosures to be expected in the financial statements.

- c. The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
- d. The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

Chapter-3: Risk Assessment and Internal Control

Q-1: The auditor shall identify and assess the risks of material misstatement at both levels to provide a basis for designing and performing further audit procedures. For the purpose of Identifying and assessing the risks of material misstatement the auditor shall Identify risks, assess the identified risks, relate the identified risks and consider the likelihood of misstatement. Explain the above in detail. *(MTP Oct 2018)*

Or

Discuss the steps to be taken by the auditor for the purpose of Identifying and assessing the risks of material misstatement as per SA 315. *(MTP Sep 2022)*

Or

For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall identify risks throughout the process of obtaining an understanding of the entity and its environment. Explain in detail along with other relevant points. *(RTP Nov 2020)*

Ans-1: Identify and assess the risks of material misstatement

- i. The auditor shall **identify and assess** the risks of material misstatement at:
 - a. The financial statement level
 - b. The assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures
- ii. For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:
 - a. Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements.
 - b. Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions.

- c. Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test and
- d. Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Q-2: The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control. (MTP Oct 2020, Oct 2021, MTP 3 Marks Mar 2023, RTP May 2023)

Ans-2: Division of Internal Control into Components: The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit

- i. The control environment
- ii. The entity's risk assessment process
- iii. Monitoring of controls
- iv. Control activities and
- v. The information system, including the related business processes, relevant to financial reporting, and communication

Q-3: The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this regard.

Ans-3: The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following are as under:

- a. The classes of transactions in the entity's operations that are significant to the financial statements
- b. The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements

- c. The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions
- d. How the information system captures events and conditions that are significant to the financial statements
- e. The financial reporting process used to prepare the entity's financial statements
- f. Controls surrounding journal entries.

Q-4: Explain what understanding should an auditor obtain regarding an entity's risk assessment process (one of the components of the internal control of the entity). (MTP Oct 2022)

Ans-4: The Entity's Risk Assessment Process- Component of Control Environment. The auditor shall obtain an understanding of whether the entity has a process for:

- a. Identifying business risks relevant to financial reporting objectives
- b. Estimating the significance of the risks
- c. Assessing the likelihood of their occurrence; and (d) Deciding about actions to address those risks. The entity's risk assessment process forms the basis for the risks to be managed. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

Q-5: Explain stating clearly what is not included in Audit Risk? (MTP Aug 2018)

Ans-5: Assessment of Risks - Matter of Professional Judgement

The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

What is not included in Audit Risk?

- i. Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.
- ii. Further, audit risk is a technical term related to the process of auditing; it does

not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

Q-6: The auditor of MARUT Ltd, engaged in manufacturing of Smart Motor Bikes, obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether:

- i. Management has created and maintained a culture of honesty and ethical behavior; and
- ii. The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

Advise what is included in control environment. Also explain the elements of control environment.

Or

Advise what is included in control environment. Also explain the elements of control environment.

Or

The auditor of FAST CARS Ltd obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether management has created and maintained a culture of honesty and ethical behavior and the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

Advise what is included in control environment. Also explain the elements of control environment. (MTP May 2020, March 2019, Aug 2018, Mar 2018)

Ans-6: Control Environment - Component of Internal Control: The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

- i. Management has created and maintained a culture of honesty and ethical behavior; and
- ii. The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

What is included in Control Environment? The control environment includes:

- i. The governance and management functions and
- ii. The attitudes, awareness, and actions of those charged with governance and management.

- iii. The control environment sets the tone of an organization, influencing the control consciousness of its people.
- iv. **Elements of the Control Environment:** Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:
1. **Communication and enforcement of integrity and ethical values** - These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
 2. **Commitment to competence** - Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
 3. **Participation by those charged with governance** - Attributes of those charged with governance such as:
 - Their independence from management.
 - Their experience and stature.
 - The extent of their involvement and the information they receive, and the scrutiny of activities.
 - The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.
 4. **Management's philosophy and operating style** - Characteristics such as management's:
 - Approach to taking and managing business risks.
 - Attitudes and actions toward financial reporting.
 - Attitudes toward information processing and accounting functions and personnel.
 5. **Organizational structure** - The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
 6. **Assignment of authority and responsibility** - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established.
 7. **Human resource policies and practices** - Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

Q-7: Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as complex calculations. Also, risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as

accounting principles for accounting estimates may be subject to differing interpretation etc. Explain in detail. (MTP 3 Marks Oct 2023, RTP Nov 2021)

Ans-7: Risks of Material Misstatement- Greater for Significant Non-Routine Transactions Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

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

Risks of material misstatement- Greater for Significant Judgmental Matters

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

Q-8: Materiality for the financial statements as a whole may need to be revised as a result of a change in circumstances that occurred during the audit. Explain with the help of example. (MTP Oct 2019)

Ans-8: Revision in Materiality level as the Audit Progresses: Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

Example

If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further

audit procedures remain appropriate.

Q-9: Briefly discuss the limitations of Internal Control. (RTP May 2023)

Ans-9: Limitations of Internal Control:

- i. **Internal control can provide only reasonable assurance:** Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control.
- ii. **Human judgment in decision-making:** Realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error.
- iii. **Lack of understanding the purpose:** Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.
- iv. **Collusion among People:** Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. **For example**, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.
- v. **Judgements by Management:** Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.
- vi. **Limitations in case of Small Entities:** Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.

On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

Q-10: XYZ & Associates, Chartered Accountants, while evaluating the operating effectiveness of internal controls, detects deviation from controls. In such a

situation, state the specific inquiries to be made by an auditor to understand these matters and their potential consequences. (MTP March 2021, May 2018)

Ans-10: Evaluating the Operating Effectiveness of Controls: When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.

When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

- i. The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
- ii. Additional tests of controls are necessary; or
- iii. The potential risks of misstatement need to be addressed using substantive procedures.

A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

Q-11: Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as materiality, size of the entity etc. Explain the other relevant considerations in the above context. (MTP March 2022, RTP May 2021, RTP Nov 2022)

Ans-11: Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- ✓ Materiality.
- ✓ The significance of the related risk.
- ✓ The size of the entity.
- ✓ The nature of the entity's business, including its organisation and ownership characteristics
- ✓ The diversity and complexity of the entity's operations.
- ✓ Applicable legal and regulatory requirements.
- ✓ The circumstances and the applicable component of internal control.
- ✓ The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- ✓ Whether, and how, a specific control, individually or in combination with

others, prevents, or detects and corrects, material misstatement.

Q-12: As a part of Risk assessment, the auditor shall determine whether any of the risks identified are in the auditor's judgement a significant risk. Mention any three guiding factors to judge as to which risks are significant risks? (May 2023)

Ans-12: Identification of Significant Risks: SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

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

- a) Whether the risk is a risk of fraud
- b) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention
- c) The complexity of transactions;
- d) Whether the risk involves significant transactions with related parties;
- e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Q-13: Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should consider the risks that arise from the use of IT systems. Explain. (MTP Aug 2018, RTP Nov 2019)

Ans-13: Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should now understand the risks that arise from the use of IT systems.

Given below are some such risks that should be considered,

- To make necessary changes to systems or programs
- Loss of inaccurate processing of data, processing inaccurate data, or both

- Unauthorized access to data
- Direct data changes (backend changes)
- Excessive access / privileged access (super users)
- Lack of adequate segregation of duties
- Unauthorized changes to systems or programs
- Failure data

Q-14: A company functions in an automated environment. Discuss in what areas data analytics can be useful for auditor of the company. *(Study Mat)*

Ans-14: The combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics. While it is true that companies can benefit immensely from the use of data analytics in terms of increased profitability, better customer service, gaining competitive advantage, more efficient operations, etc., even auditors can make use of similar tools and techniques in the audit process and obtain good results. The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs in short.

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following,

- check completeness of data and population that is used in either test of controls or substantive audit tests
- selection of audit samples - random sampling, systematic sampling
- re-computation of balances - reconstruction of trial balance from transaction data
- reperformance of mathematical calculations - depreciation, bank interest calculation.
- analysis of journal entries as required by SA 240
- fraud investigation
- evaluating impact of control deficiencies

Q-15: List any five points that an auditor should consider to obtain an understanding of the Company's automated environment. *(MTP Oct 2021, Mar2022)*

Ans-15: Understanding and Documenting Automated Environment: Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls. Given

below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment.

- Information systems being used (one or more application systems and what they are)
- their purpose (financial and non-financial)
- Location of IT systems - local vs global
- Architecture (desktop based, client-server, web application, cloud based)
- Version (functions and risks could vary in different versions of same application)
- Interfaces within systems (in case multiple systems exist)
- In-house vs Packaged
- Outsourced activities (IT maintenance and support)
- Key persons (CIO, CISO, Administrators)

Q-16: Explain the objective and enlist the activities involved in the General IT Controls over "Program Change". (MTP Oct 2022)

Ans-16: General IT Controls are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Program Change

Objective: To ensure that modified systems continue to meet financial reporting objectives.

Activities:

Change Management Process - definition, roles & responsibilities

- Change Requests - record, manage, track
- Making Changes - analyze, design, develop
- Test Changes - test plan, test cases, UAT
- Apply Changes in Production
- Emergency & Minor Changes
- Documentation - user/technical manuals
- User Training

Q-17: Discuss the various points which auditor needs to consider in determining whether it is appropriate to use audit evidence about operating effectiveness of controls obtained in previous audit, and if so, the length of the time period that may elapse before retesting a control. (MTP April 2023, Nov 2019)

Ans-17: In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

- i. The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process
- ii. The risks arising from the characteristics of the control, including whether it is manual or automated
- iii. The effectiveness of general IT-controls
- iv. The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affects the application of the control
- v. Whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- vi. The risks of material misstatement and the extent of reliance on the control.

Q-18: The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". Explain. (RTP Nov 2019 Nov 2018, May 2019)

Ans-18: The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

It can be concluded from the above that- Risk of Material Misstatement= Inherent Risk X Control Risk

Q-19: Auditor GR and Associates have been appointed to conduct audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditors do not think that it would be necessary to understand internal controls. Advise the auditor in this regard explaining clearly the benefits of understanding the internal control. (RTP May 2021)

Ans-19: The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

Benefits of Understanding the Internal Control

An understanding of internal control assists the auditor in:

- (i) identifying types of potential misstatements;
- (ii) identifying factors that affect the risks of material misstatement, and
- (iii) designing the nature, timing, and extent of further audit procedures.

Q-20: A Flow Chart is a graphic presentation of each part of the company's system of internal control. Explain elaborating each and every aspect about flow chart. (RTP Nov 18)

Ans-20: A Flow Chart: It is a graphic presentation of each part of the company's system of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system. It minimizes the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form. It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested.

It is also necessary for the auditor to study the significant features of the business carried on by the concern; the nature of its activities and various channels of goods and materials as well as cash, both inward and outward; and also a comprehensive study of the entire process of manufacturing, trading and administration. This will help him to understand and evaluate the internal controls in the correct perspective.

Q-21: Explain some of the commonly used methods for testing in an automated environment. (RTP MAY 2020)

Ans -21: When testing in an automated environment, some of the more common methods are as follows:

- Obtain an understanding of how an automated transaction is processed by doing

a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.

- Observe how a user processes transactions under different scenarios.
- Inspect the configuration defined in an application.

Q-22: Satranga Foods Private Limited is engaged in manufacturing of pickles. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Identify and explain that particular risk in detail. [RTP May 2024]

Ans-22: There is a possibility that planned audit procedures may not achieve desired result and fail to detect misstatements in revenue recognition. Such a risk is referred to as "detection risk".

SA 200 defines detection risk as the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

For example, auditor of a company uses certain audit procedures for the purpose of obtaining audit evidence and reducing audit risk, but still there will remain a risk that audit procedures used by the auditor may not be able to detect a misstatement which by nature is material, then that risk is known as detection Risk.

Detection risk comprises sampling and non-sampling risk.

- Sampling risk** is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It simply means that the sample was not representative of the population from which it was chosen.
- Non-sampling risk** is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.

Chapter-4: Audit Evidence

Q-1: Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgment. Discuss explaining clearly the meaning of audit evidence in detail. (MTP 4 Marks Oct'23, RTP Nov '19)

Ans-1: Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively.

Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs. An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige. He needs evidence to obtain information for arriving at his judgment.

Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Explaining this further, audit evidence includes:-

1. Information contained in the accounting records: Accounting records include the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
2. Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the

financial statements: Other information which the auditor may use as audit evidence includes, for example minutes of the meetings, written confirmations from trade receivables and trade payables, manuals containing details of internal control etc. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

Q-2: Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain (RTP Nov 2019 & Nov 2018)

Ans-2: Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

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

As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an

acceptably low level. The sufficiency and appropriateness of audit evidence are interrelated.

Q-3: When information to be used as audit evidence has been prepared using the work of a management's expert and having regard to the significance of expert's work for the auditor's purposes, explain the considerations auditor would consider for the purposes of his audit. (RTP May 2021)

Ans-3: When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

- i. Evaluate the competence, capabilities and objectivity of that expert
- ii. Obtain an understanding of the work of that expert and
- iii. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Q-4: Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss. (RTP May 2018)

Ans-4: Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Explaining this further, audit evidence includes: -

1. **Information contained in the accounting records:** Accounting records include the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
2. **Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements:** Other information which the auditor may use as audit evidence includes, for example minutes of the meetings, written confirmations from trade receivables and trade payables, manuals containing

details of internal control etc. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

Q-5: While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence. (RTP May 2022)

Or

Evaluating responses to inquiries is an integral part of the inquiry process. Explain. (RTP May 2018)

Ans-5: Inquiry: As per SA 500 Audit Evidence

- i. Inquiry consists of seeking information of knowledgeable persons, financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.
- ii. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- iii. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained.
- iv. Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

Q-6: Manya Textiles is manufacturer of bed sheets, curtain cloths, other handloom items etc. having its plant at Panipat. Auditors SJ & Co. is having doubts over the reliability of information given to him as audit evidence. Also,

auditors observed inconsistent information while conducting audit. Guide the auditor as to how they should proceed in the given situation. (RTP Nov 2022)

Ans -6: If:

- a. audit evidence obtained from one source is inconsistent with that obtained from another; or
- b. the auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

Q-7: CA K audited the books of accounts of E Ltd. for the financial year 2020-2021. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor and its reliability. (3 Marks, Dec 2021)

Ans-7: Audit Procedure:

Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

In view of above, it can be concluded that CA K used Inspection as an audit procedure.

Q-8: SPR Ltd has been into the media business since 1990. During the F.Y 2021-2022 many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with company's external legal counsel. Management is of the view that such meetings are necessary in some certain circumstances only. Can you list down those certain circumstances? (3 Marks May 2022)

Ans-8: Circumstances when becoming necessary to meet with external legal counsel:

In the given case of SPR Ltd., Auditor requested the management for meeting with SPR's external legal counsel.

In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims.

This may be the case, for example, where:

- (i) The auditor determines that the matter is a significant risk.
- (ii) The matter is complex.
- (iii) There is disagreement between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

Q-9: The objective of auditing is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. This can be obtained by performing which procedures? Name the types of audit procedures the auditor can perform to obtain audit evidence? (4 Marks Nov 22)

Ans-9: Audit Procedures to Obtain Audit Evidence: Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

- a. Risk assessment procedures; and
- b. Further audit procedures, which comprise:
 - i. Test of controls, when required by the SAs or when the auditor has chosen to do so; and
 - ii. Substantive procedures, including tests of details and substantive analytical procedures.

Audit procedures to obtain audit evidence can include

- a. Inspection
- b. Observation
- c. External Confirmation
- d. Recalculation
- e. Reperformance
- f. Analytical Procedures
- g. Inquiry

Q-10: Explain the meaning, objectives and scope of internal audit functions as per SA 610. Also discuss who can be appointed as Internal Auditor? (RTP May 2019)

Ans-10: Who can be appointed as Internal Auditor? As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.

Internal audit function: A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

The objectives and scope of internal audit functions: As per SA-610, "Using the Work of an Internal Auditor", the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:

1. **Activities Relating to Governance:** The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.
2. **Activities Relating to Risk Management:** The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process). The internal audit function may perform procedures to assist the entity in the detection of fraud.
3. **Activities Relating to Internal Control**
 - i. **Evaluation of internal control.** The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
 - ii. **Examination of financial and operating information.** The internal audit function may be assigned to review the means used to identify,

recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.

- iii. **Review of operating activities.** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.
- iv. **Review of compliance with laws and regulations.** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Q-11: The sample size can be determined by the application of a statistically - based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.

Explain Stating the examples of factors that the auditor may consider when determining the sample size for tests of controls. (MTP 5 Marks Oct 2018 , MTP 4 Marks March 2019 , MTP 3 Marks May 2020)

Ans-11: The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.

Examples of Factors Influencing Sample Size for Tests of Controls: The following are factors that the auditor may consider when determining the sample size for tests of controls. These factors, which need to be considered together, assume the auditor does not modify the nature or timing of tests of controls or otherwise modify the approach to substantive procedures in response to assessed risks.

- When there is an increase in the extent to which the auditor's risk assessment takes into account relevant controls. The more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the risk of material misstatement will be, and the larger the sample size will need to be. When the auditor's assessment of the risk of material misstatement at the assertion level includes an expectation of the operating effectiveness of controls, the auditor is required to perform tests of controls. Other things being equal, the greater the reliance the auditor

places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls (and therefore, the sample size is increased). Thus, sample size will increase.

- If there is an increase in the tolerable rate of deviation. Then sample size will decrease, as lower the tolerable rate of deviation, larger the sample size needs to be.
- When there is an increase in the expected rate of deviation of the population to be tested then sample size will increase, as higher the expected rate of deviation, larger the sample size needs to be so that the auditor is in a position to make a reasonable estimate of the actual rate of deviation. Factors relevant to the auditor's consideration of the expected rate of deviation include the auditor's understanding of the business (in particular, risk assessment procedures undertaken to obtain an understanding of internal control), changes in personnel or in internal control, the results of audit procedures applied in prior periods and the results of other audit procedures. High expected control deviation rates ordinarily warrant little, if any, reduction of the assessed risk of material misstatement.
- An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will increase the sample size. Thus, the greater the level of assurance that the auditor desires that the results of the sample are in fact indicative of the actual incidence of deviation in the population, the larger the sample size needs to be.
- In case of large populations, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling may not be as efficient as alternative means of obtaining sufficient appropriate audit evidence. Therefore, there will be negligible effect on sample size due to increase in the number of sampling units in the population.

Q-12: XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques. Advise the auditor in accordance with SA 530. (MTP 4 Marks Oct 19, RTP May 18)

Ans-12: Stratification and Value-Weighted Selection: In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is

appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques.

Stratification: Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.

The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population.

For example, 20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial). If a class of transactions or account balance has been divided into strata, the misstatement is projected for each stratum separately. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance.

Value-Weighted Selection: When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population, **for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units.** One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes.

This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.

Q-13: Audit testing done through Statistical sampling is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Explain and also state advantages of Statistical sampling. (MTP 4 Marks Oct 20)

Ans-13:

1. size of the area (universe) tested.
2. The sample selection is more objective and thereby more defensible.
3. The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
4. It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) *i.e.* the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
5. It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.
6. It is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.

Q-14: CA X is not sure about the kind of Sampling method to be used for audit of a company. Advise him about the choice of methods (name of methods only) of Sampling to be used in various circumstances. Also explain briefly the advantages of the Sampling to be used by him in auditing. (MTP 3 Marks Nov 2021)

Ans-14: Sample Selection:

CA. X should obtain the knowledge before using the sampling methods. The principal methods areas follows:

1. Random selection.
2. Systematic selection.
3. Monetary Unit sampling.
4. Haphazard selection.
5. Block selection.

Advantages of Statistical Sampling in Auditing:

- i. The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- ii. The sample selection is more objective and thereby more defensible.
- iii. The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- iv. It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
- v. It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

Q-15: ABC Ltd is a Large Company with huge purchase and sales transactions. Which sampling approach is recommended in such a company? Explain giving features of such sampling approach along with example (MTP 3 Marks March 2022)

Ans-15: In larger organisations, with huge transactions, statistical sampling is always recommended as it is unbiased, and the samples selected are not prejudged.

Features/Characteristics of Statistical Sampling:

1. Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
2. Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
3. There is no personal bias of the auditor in case of statistical sampling. Since it is scientific, the results of sample can be evaluated and projected on the whole population in a more reliable manner.

For Example: An auditor while verifying the Purchases during the year realised that the purchase transactions in that year are more than 45000 in number, then in such case, statistical sampling will be highly recommended in the audit program. Random Sampling (discussed ahead in this topic) is the method you decide to choose sample in such a situation.

Q-16: There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. Explain. (MTP 4 Marks April 2022, RTP Nov 2019)

Ans-16: No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. This invariably leads to more emphasis on routine checking, which often is not necessary in view of the time and the cost involved. With the shift in favour of formal internal controls in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly diminished and auditors often find extensive routine checking as nothing more than a ritual because it seldom reveals anything material. Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of non-consequential routine checking. By routine checking we traditionally think of extensive checking and vouching of all entries.

Q-17: It is imperative for the auditor to project misstatements for the population while performing audit procedures through sampling. Comment. (MTP 3 Marks Oct 2023, PYP 3 Marks, Nov 2020, RTP May 2020, May 2019 & Nov 2023)

Ans-17:

- i. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.
- ii. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.
- iii. For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

Q-18: Explain the sampling method which involves selection of a block(s) of contiguous items from within the population. Also give example (RTP May 2020)

Ans-18: Block Sampling: This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can

be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

Example

Take the first 200 sales invoices from the sales day book in the month of September; alternatively take any four blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.

Q-19: Krishna Cycles Ltd is engaged in manufacturing of different type of Bicycles. Ongoing through its financial statements for the past years, it is observed that inventory is material to the financial statements. You as an auditor of the company wanted to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory as appearing in the financial statements. Discuss, how would you proceed as an auditor. (MTP 5 Marks Aug 2018 & Oct 2018, March 2019, May2020)

Ans-19: When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

- a. Attendance at physical inventory counting, unless impracticable, to
 - I. Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
 - II. Observe the performance of management's count procedures;
 - III. Inspect the inventory; and
 - IV. Perform test counts; and
- b. Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

Q-20: While conducting audit of Vee Ltd, CA Aman, auditor of the company, found that some goods are lying with third party for a long period. Advise Aman how will he verify them. (MTP 4 Marks Oct 2021)

Ans-20: When inventory under the custody and control of a third party is:

1. Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
2. Perform inspection or other audit procedures appropriate in the circumstances.

Q-21: TRM Ltd. is a company engaged in manufacture of beauty products. It has hair care segment, skin care segment and kids' beauty products. The auditor wants to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework. Suggest the audit procedures in the given case. *(MTP 4 Marks March 2021)*

Ans-21: The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:

1. Obtaining an understanding of the methods used by management in determining segment information. Further,
 - i. Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
 - ii. Where appropriate, testing the application of such methods; and
2. Performing analytical procedures or other audit procedures appropriate in the circumstances.

Q-22: GPS & Co, Chartered Accountants, conducting the audit of Pratibha Ltd., a listed company for the year ended 31.03.2022 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GPS & Co wanted to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GPS & Co with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing. *(RTP May 2022)*

Ans-22: The auditors, GPS & Co wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501- "Audit Evidence— Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

- i. Sales, transfers and charges between segments, and elimination of inter - segment amounts.
- ii. Comparisons with budgets and other expected results, for example,

- operating profits as a percentage of sales.
- iii. The allocation of assets and costs among segments.
- iv. Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

Q-23: When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests. (RTP May '20, Old & New SM)

Ans-23: When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

- a. Determining the information to be confirmed or requested;
- b. Selecting the appropriate confirming party;
- c. Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- d. Sending the requests, including follow-up requests when applicable, to the confirming party.

Q-24: CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level. (PYP 4 Marks, July 2021)

Ans-24: Negative confirmations are a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative information provides less persuasive audit evidence than positive confirmations. Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

- a. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion
- b. The population of items subject to negative confirmation procedures

comprises a large number of small, homogeneous, account balances, transactions or conditions

- c. A very low exception rate is expected; and
- d. The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

Q-25: CA P is the auditor of MN Ltd. While scrutinising the accounts of MN Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31st March, 2023 for which external confirmations are not available, CA P wants to send external confirmation request to selected Trade payables but management of MN Ltd. refused for the same. Discuss how CA P should deal in this regard as per relevant Standard on Auditing. (PYP 4 Marks May2023, PYP 4 Marks, Nov 2020)

Ans-25: If management refuses to allow the auditor to send a confirmation request, CA P should deal in this regard in the manner prescribed in SA 505 explained hereunder:

- a. Inquire as to management's reasons for the refusal and seek audit evidence as to their validity and reasonableness
- b. Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures and
- c. Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.

The auditor shall also determine the implications for the audit and the auditor's opinion in accordance with SA 705.

Q-26: M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2020- 21-. They have been appointed as statutory auditors of TUV Ltd. for the first time. What is the objective of the engagement partner in terms of SA 510? (Old & New SM)

Ans-26: In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- a. Opening balances contain misstatements that materially affect the current

period's financial statements; and

- b. Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Q-27: M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach? (5 Marks, Nov '18, Old & New SM)

Ans-27: Initial audit engagement is an engagement in which either

- i. The financial statements for the prior period were not audited; or
- ii. The financial statements for the prior period were audited by a predecessor auditor.

From the above, it is quite clear that CA Pankaj is not correct in his approach and therefore would be required to follow the initial audit engagement and also apply audit procedures regarding opening balances.

Audit Procedures regarding Opening Balances; The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- a. Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- b. Determining whether the opening balances reflect the application of appropriate accounting policies; and
- c. Performing one or more of the following:
 - I. Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
 - II. Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - III. Performing specific audit procedures to obtain evidence regarding the opening balances.

Q-28: The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.

During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples. (RTP Nov 2021, MTP Oct 2023)

Ans-28: During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example :

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator e.g., prospectuses)

Q-29: The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples. (RTP May 2020, Old & New SM)

Ans-29: Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances,

give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.

Example

- Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Q-30: CA Amar wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2020-21. The rent amounts to Rs.50,000/- per month for the year. The monthly rent payments are consistent with the rent agreement. However, the other companies in the similar industry are paying rent of Rs. 10,000/- per month for a similar location. How will applying the analytical procedures impact the verification process of such rental payments by XYZ Ltd.? *(MTP 3 Marks April 2021, Old & New SM)*

Ans-30: If CA Amar checks in detail the monthly rent payments, he may find that such payments are consistent with the rent agreement i.e. XYZ Ltd. paid Rs. 50,000/- per month as rent and the same is getting reflected in the rent agreement. Here, CA Amar may not be able to find out the inconsistency in the rent payment with respect to rent payment prevalent in the similar industry for rent of the similar location. If CA Amar applies analytical procedure i.e. compares the rent payment by XYZ Ltd. with the similar payments made by companies in similar industry and similar area, he will notice an inconsistency in such rent payments as the other companies are paying a very less monthly rent in similar industry for similar area. However, if CA Amar does not make such comparison and only checks the monthly payments and rent agreement of XYZ Ltd., he would not have found such inconsistency and as such the misstatement may remain undetected.

Q-31: Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances. *(MTP 4 Marks Oct 2021)*

Ans-31: Analytical Review Procedures: The following analytical review procedures may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances-

- i. comparison of closing balances of trade receivables, loans and advances with the corresponding figures for the previous year
- ii. comparison of the relationship between current year trade receivable balances and the current year sales with the corresponding budgeted figures, if available
- iii. comparison of actual closing balances of trade receivables, loans and advances with the corresponding budgeted figures, if available
- iv. comparison of current year's ageing schedule with the corresponding figures for the previous year
- v. comparison of significant ratios relating to trade receivables, loans and advances with similar ratios for other firms in the same industry, if available
- vi. comparison of significant ratios relating to trade receivables, loans and advances with the industry norms, if available.

Q-32: For the purposes of the SAs, the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Explain giving examples of both. (RTP Nov 2021)

Ans-32: Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entity of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

Q-33: CA Kanika audited books of accounts of Engineering Ltd. for the financial year 2022-2023. The auditor used an audit procedure according to

which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor. Comment on reliability of audit evidence obtained by performing such an audit procedure in some situations. (RTP May 2024)

Ans-33: Audit Procedure:

Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. In view of above, it can be concluded that CA Kanika used Inspection as an audit procedure.

Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

Example of inspection used as a test of controls is inspection of records for evidence of authorization.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

Q-34: CA J is conducting statutory audit of Gemini Ltd engaged in manufacturing of pharma products. The company is fairly large one and has a well-functioning internal audit department. While considering sending out external confirmation requests to trade receivables outstanding as on date of financial statements, CA J has delegated the process of choosing trade receivables, designing requests and receiving responses from customers to internal audit department. The responses are also received on the mail id of internal audit department. Is the approach of CA J proper? (May 2024)

Ans-34: When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

1. Determining the information to be confirmed or requested;
2. Selecting the appropriate confirming party;
3. Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
4. Sending the requests, including follow-up requests when applicable, to the confirming party.

In the given case, it appears that external auditor has delegated entire work of sending out external confirmation requests to internal audit department over which he has no control. Further, responses to external confirmation requests are received on mail id of internal audit department. All these acts are not in line with requirements under SA 505.

Q-35: The newly appointed auditor of BTN Limited wants to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. What audit procedures should he perform for this purpose? (May 2024)

Ans-35: Audit Procedure Regarding Opening Balances: The newly appointed auditor of BTN Ltd shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

The auditor of BTN Ltd shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

1. Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss.
2. Determining whether the opening balances reflect the application of appropriate accounting policies; and
3. Performing one or more of the following:

- i. Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements.
- ii. Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- iii. Performing specific audit procedures to obtain evidence regarding the opening balances.

Q-36: SPR Ltd has been into the media business since 2001. During the F.Y 2022-2023, many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with company's external legal counsel. Management is of the view that such meetings are necessary in certain circumstances only. Can you list down such circumstances? (May 2024)

Ans-36: Circumstances when it becomes necessary to meet with company's external legal counsel:

In the given case of SPR Ltd., Auditor requested the management for meeting with SPR's external legal counsel.

In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims.

This may be the case, **for example**, where:

- (i) The auditor determines that the matter is a significant risk.
- (ii) The matter is complex.
- (iii) There is disagreement between management and the entity's external legal counsel.

Chapter-5: Audit of Items of Financial Statements

Question: Newton Ltd. has made loans and advances on the basis of following securities to various borrowers. As an auditor what type of documents can be verified to ensure that the company holds a legally enforceable security?

- i. Shares and Debentures
- ii. Life Insurance Policy
- iii. Hypothecation of goods [RTP -MAY 2021]

Answer: Documents to be seen in case of Securities:

Types of Security	Documents etc. to be seen
(i) Shares and debentures	The scrip and the endorsement thereon of the name of the transferee, in the case of transfer.
(ii) Life Insurance Policy.	Assignment of policy in favour of the lender, duly registered with the insurer
(iii) Hypothecation of goods	Deed of hypothecation or other document creating the charge, together with a statement of inventories held at the Balance Sheet date

Question: Explain how you will verify the items given while conducting an audit of an entity:

- a. Recovery of Bad debts written off
- b. Receipt of Insurance claims
- c. Payment of Taxes
- d. Sale proceeds of scrap material [RTP -MAY 2022]

Answer:

- a. Recovery of bad debts written off is verified with reference to relevant correspondence and proper authorization.

- i. Ascertain the total amount lying as bad debts and verify the relevant correspondence with the trade receivables whose accounts were written off as bad debt.
 - ii. Ensure that all recoveries of bad debts have been properly recorded in the books of account.
 - iii. Examine notification from the Court or from bankruptcy trustee. Letters from collecting agencies or from account receivables should also be seen.
 - iv. Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.
 - v. Vouch acknowledgement receipts issued to account receivables or trustees.
 - vi. Review the internal control system regarding writing off and recovery of bad debts.
- b. **Receipt of Insurance Claims:** Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims
- i. The auditor should examine a copy of the insurance claim lodged with the insurance company correspondence with the insurance company and with the insurance agent should also be seen. Counterfoils of the receipts issued to the insurance company should also be seen.
 - ii. The auditor should also determine the adjustment of the amount received in excess or short of the value of the actual loss as per the insurance policy.
 - iii. The copy of certificate/report containing full particulars of the amount of loss should also be verified.
 - iv. The accounting treatment of the amount received should be seen particularly to ensure that revenue is credited with the appropriate amount and that in respect of claim against asset, the Statement of Profit and Loss is debited with the short fall of the claim admitted against book value, if the claim was lodged in the previous year but no entries were passed, entries in the Statement of Profit and Loss should be appropriately described.
- c. **Payment of Taxes:**
- i. Obtain the computation of taxes prepared by the auditee and verify whether it is as per the Income Tax Act/GST Act/ Rules/ Notifications/ Circulars etc.
 - ii. Examine relevant records and documents pertaining to payment of advance income tax and self assessment tax.

- iii. Payment on account of income-tax and other taxes like GST consequent upon a regular assessment should be verified by reference to the copy of the assessment order, notice of demand and the receipted challan acknowledging the amount paid.
 - iv. The penal interest charged for non-payment should be debited to the interest account.
 - v. Nowadays, electronic payment of taxes is also in trend. Such electronic payment of taxes by way of internet banking facility or credit or debit cards shall also be verified.
 - vi. The assessee can make electronic payment of taxes also from the account of any other person. Therefore, it should be verified that the challan for making such payment is clearly indicating the PAN No./TAN No./TIN No./GSTIN etc. of the assessee on whose behalf the payment is made.
- d. Sale Proceeds of Scrap Material:**
- i. Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.
 - ii. Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.
 - iii. Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.
 - iv. Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years
 - v. Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
 - vi. See that scrap materials sold have been billed and check the calculations on the invoices.
 - vii. Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it and sold as scrap
 - viii. Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

Question: While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss explaining clearly

the provisions relating to discount on issue of shares and its verification by the auditor. [RTP -MAY 2022]

Answer: Shares issued at a discount

According to Section 53 of the Companies Act, 2013,

1. A company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.
2. Any share issued by a company at a discounted price shall be void.
- 2A. Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
3. Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

- i. The movement in share capital during the year and wherever there is any issue,
- ii. He should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
- iii. Further, auditor should also verify that in case a company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

In the given case of Air Space Ltd, it is clear that it can issue shares to its creditors when its debt is converted into shares in accordance with approved restructuring scheme.

Question: Name the assertions for the following audit procedures:

- i. Year end inventory verification.
- ii. Depreciation has been properly charged on all assets.
- iii. The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
- iv. All liabilities are properly recorded in the financial statements.
- v. Related party transactions are shown properly. [RTP -NOV 2022]

Answer:

- i. Year-end inventory verification: **Existence Assertion.**
- ii. Depreciation has been properly charged on all assets: **Valuation Assertion.**
- iii. Title deed of lands disclosed in the Balance Sheet are held in the name of the Company: **Rights & Obligations Assertion.**
- iv. All liabilities are properly recorded in the financial statements: **Completeness.**
- v. Related party transactions are shown properly: **Presentation & Disclosure.**

Question: PK Pvt Ltd, based in Moradabad, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2022. It is also analysed from Export Sales account of the company that large number of small shipments were almost dispatched daily during month of March 2022. List out few audit procedures you would adopt as an auditor to verify completeness assertion of export trade receivables. [RTP -NOV 2022]

Answer: Completeness assertion in respect of account balances means that all balances which should have been recorded have been recorded. The auditor needs to satisfy himself about cut off so that there is no understatement or overstatement in account balances of export receivables.

In this context, while verifying completeness assertion of export trade receivables, following audit procedures are required:-

1. Check that in respect of invoices raised in last few days nearing the cutoff date, goods have been actually dispatched and not lying with the company.
2. Check stock records, e-way bill, and transporter receipt regarding actual movement of goods. It would provide assurance that export invoices in respect of which revenue was booked have been actually moved out of company's premises.

3. Ensure that all goods invoiced prior to cut off date/year end have been included in export receivables on test check basis.
4. Ensure that no goods despatched after year end have been included in export receivables by tracing entries in export sales, stock records of next year. The same can be verified from e-way bills also.
5. Match invoices to despatch/shipping details. Further match invoices dates to despatch dates to see if sales are being recorded in correct accounting period.
6. Test invoices in receivable report. Select invoices from ageing report of export receivables and compare them with supporting documentation to ensure that these are billed with correct names, dates and amounts.

Question: B Ltd. is covered u/s 135 of the Companies Act, 2013 i.e. Corporate Social Responsibility (CSR). What matters (other than the amount spent, amount not spent, amount required to be spent etc.) shall be disclosed by the company with regard to CSR activities done by the company? [MAY 2022]

Answer: Corporate Social Responsibility (CSR): Since B Ltd is covered under section 135 of the Companies Act, the following matters shall be disclosed by the B Ltd with regard to CSR activities:

- a. total of previous years shortfall,
- b. reason for shortfall,
- c. nature of CSR activities,
- d. details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
- e. where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

Question: CA R is the statutory auditor of QRS Ltd. While performing testing of additions during the year, he wanted to verify that:

- i. All PPE (property, plant and equipment) are in the name of the entity he is auditing.
- ii. For all additions to land and building in particular, the auditor desires to have concrete about the ownership.
- iii. The auditor wants to know whether the entity has valid legal ownership rights over the PPE, where it is kept as security for any borrowings.

Advise the auditor on the audit procedure to be undertaken by him to establish the Rights and Obligations of the entity over the PPE. [DEC 2021]

Answer: Audit procedure to establish Rights and Obligations of the entity over PPE:

- i. In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, CA R, the statutory auditor of B Ltd, while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. Verify whether the PPE additions have been approved by authorized person
- ii. For all additions to land, building in particular, CA R, the statutory auditor of B Ltd, should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.
- iii. The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date.
- iv. in case the entity has given such immovable property as security for any borrowings and the original title deeds are not available with the entity, CA R, the statutory auditor of B Ltd should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immovable property as security.
- v. In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

Question: Profit and Loss account of an organization shows various types of expenses like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to

running of business operations. What are the attributes that an auditor generally prefers for vouching these types of expenses? [DEC 2021]

Answer: Attributes to be preferred for vouching other expenses:

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:

- i. Whether the expenditure pertained to current period under audit;
- ii. Whether the expenditure qualified as a revenue and not capital expenditure;
- iii. Whether the expenditure had a valid supporting documents like travel tickets, insurance policy, third party invoice etc.;
- iv. Whether the expenditure has been classified under the correct expense head;
- v. Whether the expenditure was authorised as per the delegation of authority matrix;
- vi. Whether the expenditure was in relation to the entity's business and not a personal expenditure.

Question: How is "Cash and cash equivalents" disclosed in the Financial Statements as required under Schedule III (part I) to Companies Act, 2013? [DEC 2021]

Answer: Disclosure of Cash & Cash Equivalent in the Financial Statements:

Regarding Cash and cash equivalents- Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:

- i. Cash and cash equivalents shall be classified as:
 - a. Balances with banks;
 - b. Cheques, drafts on hand;
 - c. Cash on hand;
 - d. Others (specify nature)
- ii. Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

- iii. Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- iv. Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- v. Bank deposits with more than 12 months' maturity shall be disclosed separately.

Question: Statutory Auditors of TRB Ltd. observed various instances when either the TDS required to be deducted has not been deducted or deducted at lower than prescribed rates resulting in non-compliance of Income Tax provisions. Besides this, non-compliance under other acts like Labour Laws was also noticed by the auditor. What type of policies and procedures will you implement to assist in prevention and detection of non-compliance with laws and regulations? [DEC 2021]

Answer: Types of policies and procedures to assist prevention and detection of non-compliance with laws & regulation:

The following are examples of the types of policies and procedures, TRB Ltd may implement to assist in the prevention and detection of non-compliance with laws and regulations:

- i. Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- ii. Instituting and operating appropriate systems of internal control.
- iii. Developing, publicizing and following a code of conduct.
- iv. Ensuring employees are properly trained and understand the code of conduct.
- v. Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
- vi. Engaging legal advisors to assist in monitoring legal requirements.
- vii. Maintaining a register of significant laws and regulations with
- viii. which the entity has to comply within its particular industry and a record of complaints.

Question: Whether it is possible to independently verify the correctness of some of the items of expenses included in the statement of profit and loss? Explain with the help of some examples. [DEC 2021]

Answer: Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss.

For instance, the cost of importing goods which are subjected to an ad-valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by sugar mill can be verified independently from the amount of excise duty/ GST paid.

Similarly, the amount of any income or expenses which has a direct relationship with the amount of profits or that of sales can be verified independently, *e.g.*, commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.

Thus, it is important to note that Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

Question 15: CA "X" while conducting an audit of Joyful Ltd. found a considerable increase in sales as compared to the previous year, he doubts that few fictitious sales have been recorded by the company to overstate its revenues. Discuss any four audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated? [JULY 2021]

Answer 15: CA X, having doubts about fictitious sales being recorded by Joyful Ltd. would ensure that revenue is not overstated by performing following audit procedures:

- Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
- Test check few invoices with their relevant entries in sales journal.

- Obtain confirmation from few customers to ensure genuineness of sales transaction
- Whether any fictitious customers and sales have been recorded.
- Whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
- Whether unearned revenue recorded as earned.
- Whether any substantial uncertainty exists about collectability
- Whether customer obligations are contingent on other actions (financing, resale etc.)

Question: The value of intangible assets may diminish due to efflux of time, use and/or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Discuss the audit procedures to be applied by the auditor to ensure that Intangible assets have been valued appropriately and as per generally accepted accounting policies and practices.

[JULY 2021]

Answer: The value of intangible assets may diminish due to efflux of time, use and/or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained and the values of intangible asset would be shown at higher amounts.

The auditor should:

- Verify that the entity has charged amortization on all intangible assets;
- Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

The auditor should also verify whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any

Question: You have been appointed as an auditor of VJM Schools. Discuss the points which merit your consideration as an auditor while verifying Assets and Liabilities of VJM Schools. [JULY 2021]

Answer: Verification of Assets & Liabilities of VJM Schools:

1. Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.
2. Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet and not transferred to revenue, unless they are not refundable.
3. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
4. Ascertain that the system ordering inspection on receipt and issue of provisions, food stuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
5. Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.

Question: Depreciation and amortisation expense generally constitute an entity's significant part of overall expenses and have direct impact on the profit/loss of the entity. What are the attributes, the Auditor needs to consider while verifying Depreciation and amortisation expense. [JAN 2021]

Answer: Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of Companies Act or other statutes, to the extent applicable on the respective industry and as per generally accepted accounting principles.

Auditor needs to consider the following attributes while verifying for depreciation and amortization expenses:

- Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
- Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act/ applicable accounting standards.
- Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- Whether depreciation and amortisation charges are valid.
- Whether depreciation and amortisation charges are accurately calculated and recorded.
- Whether all depreciation and amortisation charges are recorded in the appropriate period.
- Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately have been properly identified.
- Whether the most appropriate depreciation method for each separately depreciable component has been used.

Question: ABC Limited has a closing balance of work in progress of inventories aggregating Rs.850 lakhs in their balance sheet as at March 31, 2020.

As Statutory Auditor of ABC Limited, explain various audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices. [JAN 2021]

Answer: Audit procedure which needs to be performed to confirm work in progress worth Rs.850 lakhs has been valued appropriately and as per generally accepted accounting policies and practices is given hereunder:

1. Ascertain how the various stages of production/ value add are measured and in case estimates are made, understand the basis for such estimates.
2. Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
3. Ensure that material costs exclude any abnormal wastage factors.

Question: As a Statutory Auditor of the company list out audit procedure required to be undertaken for the recognition of following other income:

- i. Interest income from fixed deposit
- ii. Dividend income
- iii. Gain/(loss) on sale of investment in mutual funds. [JAN 2021]

Answer: Statutory auditor would perform the following audit procedure for recognition of different items given in the question:

1. Interest income on fixed deposits is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate.
2. Dividends are recognised in the statement of profit and loss only when:
 - i. the entity's right to receive payment of the dividend is established;
 - i. it is probable that the economic benefits associated with the dividend will flow to the entity; and
 - ii. the amount of the dividend can be measured reliably.
3. Gain/(loss) on sale of investment in mutual funds is recorded as other income on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments.

Question: XYZ Ltd. made huge additions to Intangible assets during the period 01-04-2021 to 31-03-2022 i.e. period under audit. You have been appointed as an auditor and you want to verify the additions made to intangible assets during the period. Suggest the audit procedure to verify the additions to intangible assets. [MTP NOV 2022]

Answer:

1. Verify the movement in the intangible assets schedule (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. Opening balances + Additions - Deletions = Closing balances. Tally the closing balances to the entity's books of account.
2. Check the arithmetical accuracy of the movement in intangible assets schedule.

For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures:

- i. For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26.
- ii. Ensure that no cost related to research (or from the research phase of an internal project) gets recognized as intangible asset.
- iii. Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit.
- iv. Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel.
- v. Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis.
- vi. In relation to deletions of intangible assets, understand from the management the reason and rationale for deletion and the manner of disposal. Obtain the management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, example inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.

Question: Reserves are a vital source of financing by internal means. Explain and also discuss the meaning of reserves along with revenue reserve and capital reserve. [MTP NOV 2022]

Answer: Reserves are the amounts appropriated out of profits that are not intended

- to meet any liability,

- contingency,
- commitment or
- diminution in the value of assets known to exist as at the date of the Balance Sheet.

Reserves are a vital source of financing by internal means. They are held for the purpose of distribution of dividend or financing the expansion of the company or strengthening the company financially. The company utilizes the reserves according to the nature and type of such reserve. The reserves can be segregated as **revenue or capital reserves**.

Revenue reserves represent profits that are available for distribution to shareholders or below purposes such as:

- To supplement divisible profits in lean years,
- to finance an extension of business,
- to augment the working capital of the business or
- to generally strengthen the company's financial position.

Capital Reserve represents a reserve which does not include any amount regarded as free for distribution. They can be utilized only for certain limited purposes.

Example

Securities premium, capital redemption reserve.

It may be noted that if a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that these are to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve.

Question: Explain how you would verify Employee Benefit Expense incurred by a Company. [MTP NOV 2022]

Answer: The auditor shall verify that:

- i. Employee benefit expense has been incurred during the period in respect of the personnel employed by the entity. Employee benefit expense does not include the cost of any unauthorized personnel.
- ii. Employee benefit expenses in respect of all personnel have been fully accounted for.

- iii. Employee benefit expenses recognized during the period relates to the current accounting period only.
- iv. Employee benefit expense has been measured/ calculated accurately. Any adjustments such as tax deduction at source have been correctly reconciled and accounted for.
- v. Employee benefit expense has been fairly allocated between:
 - Operating expenses incurred in production activities;
 - General and administrative expenses; and
 - Cost of personnel relating to any self-constructed assets other than inventory.

Question: The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares. Is the statement correct. Explain. [MTP NOV 2022]

Answer: The statement is not correct.

The securities premium account may be applied by the Company for the following purposes:

- a. towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares
- b. in writing off the preliminary expenses of the Company;
- c. in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- d. in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- e. for the purchase of its own shares or other securities under section 68.

Question: The auditor has to ensure whether PPE has been valued appropriately and as per generally accepted accounting policies and practices and also the entity has valid legal ownership rights over the PPE claimed to be held by the

entity and recorded in the financial statements. Explain how the auditor will verify the same. [MTP NOV 2022]

Answer: The auditor has to ensure whether PPE has been valued appropriately and as per generally accepted accounting policies and practices.

The value of fixed assets/ PPE depreciates due to efflux of time, use and obsolescence. The diminution of the value represents an item of cost to the entity for earning revenue during a given period. Unless this cost in the form of depreciation is charged to the accounts, the profit or loss would not be correctly ascertained, and the values of PPE would be shown at higher amounts.

The auditor should:

- Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non-depreciable like freehold land;
- Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable.
- The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 - Impairment of Assets.

To verify whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements

- In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
- For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.

- The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date.
- In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.
- In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

Question: While checking sales of the client, the auditor has to ensure that all sales are accurately measured as per applicable accounting standards and correctly journalized, summarized, and posted. Explain the audit procedures to ensure the same. [MTP NOV 2022]

Answer: While checking sales of the client, the auditor has to ensure that all sales are accurately measured as per applicable accounting standards and correctly journalized, summarized, and posted. The auditor can perform the following procedures to ensure the same.

- Trace a few transactions from inception to completion. (Examination in depth)
- E.g: Take few sales transaction, and check from the receipt of sales order to the payment of receivable balance, every underlying document to ensure if it is properly recorded at every stage and measured accurately taking into consideration all the incentives, discounts, if any. The recognition shall be according to the revenue recognition policy of the entity.
- If the client is engaged in export sales, then compliance with AS 11 shall be ensured.
- Auditor must understand client's operations and related GAAP issues e.g. point of sale revenue recognition vs. percentage of completion, wherever applicable.
- Compare the rate of sales affected with related parties and review them for collectability, as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.

Question: Explain how you would verify rent expense incurred by a Company.
[MTP NOV 2022]

Answer: Rent expense can be verified by:

- Obtaining a month wise expense schedule along with the rent agreements.
- Verifying if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement.
- Giving specific consideration to the escalation clause in the agreement to verify if the rent was required to be recorded on a straightline basis during the period under audit.
- Also, verifying if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity.

Question: While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss explaining clearly the provisions relating to discount on issue of shares and its verification by the auditor. [MTP NOV 2022]

Answer: Shares issued at a discount

According to Section 53 of the Companies Act, 2013,

1. a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.
2. any share issued by a company at a discounted price shall be void.
- 2a. Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
3. Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may

extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

- i. the movement in share capital during the year and wherever there is any issue,
- ii. he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
- iii. Further, auditor should also verify that in case a company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

In the given case of Air Space Ltd, it is clear that it can issue shares to its creditors when its debt is converted into shares in accordance with approved restructuring scheme.

Question: While auditing the accounts of ABC Ltd, a member of audit team is not clear about :

- i. the criteria regarding classification of liability into current liability and non-current liability.
- ii. Classification of Reserves and Surplus

You being the senior member of audit team guide the member of the audit team about such criteria and classification as per general instructions for preparation of balance sheet as per Schedule III. [MTP MAY 2022]

Answer 29:

- i. A liability shall be classified as current when it satisfies any of the following criteria:

- a. it is expected to be settled in the company's normal operating cycle;
- b. it is held primarily for the purpose of being traded;
- c. it is due to be settled within twelve months after the reporting date; or
- d. the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities shall be classified as non-current.

ii. **Reserves and Surplus shall be classified as:**

- a. Capital Reserves;
- b. Capital Redemption Reserve;
- c. Securities Premium;
- d. Debenture Redemption Reserve;
- e. Revaluation Reserve;
- f. Share Options Outstanding Account;
- g. Other Reserves - (specify the nature and purpose of each reserve and the amount in respect thereof);
- h. Surplus i.e. balance in Statement of Profit & Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc. (Additions and deductions since last balance sheet to be shown under each of the specified heads)

Note: A reserve specifically represented by earmarked investments shall be termed as a 'fund'.

Note: Debit balance of statement of profit and loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

Question: Proceedings have been initiated against the company ABC Ltd for holding one of its property as benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder. State the disclosure requirements to be complied with by ABC Ltd as per Schedule III to the Companies Act, 2013. [MTP MAY 2022]

Answer: Details of Benami Property held

Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:-

- i. Details of such property, including year of acquisition,
- ii. Amount thereof,
- iii. Details of Beneficiaries,
- iv. If property is in the books, then reference to the item in the Balance Sheet,
- v. If property is not in the books, then the fact shall be stated with reasons,
- vi. Where there are proceedings against the company under this law as an abettor of the transaction or as the transferor then the details shall be provided,
- vii. Nature of proceedings, status of same and company's view on same.

Question: "While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel but for other expenses, an auditor generally prefers to verify other attributes." Mention those attributes. [MTP NOV 2021]

Answer: While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:

- i. Whether the expenditure pertained to current period under audit;
- ii. Whether the expenditure qualified as a revenue and not capital expenditure;
- iii. Whether the expenditure had a valid supporting like travel tickets, insurance policy, third party invoice etc.;

- iv. Whether the expenditure has been classified under the correct expense head;
- v. Whether the expenditure was authorised as per the delegation of authority matrix;
- vi. Whether the expenditure was in relation to the entity's business and not a personal expenditure

Question: Management of Z Ltd. wants to include all the cost incurred by the Company in valuing the cost of its inventories. The Accountant is, however, of the view that certain costs should be excluded from the cost of inventories and should be recognised as expenses for the period in which they are incurred. What are such costs that should be excluded while determining the cost of inventories? [MTP NOV 2021]

Answer: Examples of costs to be excluded in determining cost of Inventory:

In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

- i. abnormal amounts of wasted materials, labour, or other production costs;
- ii. storage costs, unless those costs are necessary in the production process prior to a further production stage;
- iii. administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- iv. selling and distribution costs.

In the given situation, contention of Z Ltd. is not correct to include all the cost of its inventories while determining the cost of inventory. However, contention of accountant is correct that certain cost should be excluded from the cost of inventories and to be recognised as expenses in period in which they are incurred.

Question: State assertions that are implied in the extract of financial statement given below:

	Particulars	(Rs.)	(Rs.)
	Plant & Machinery (at Cost)		4,00,000

Less:	Depreciation:		
	Up to Previous year	1,40,000	
	For the year	<u>26,000</u>	<u>1,66,000</u>
			<u>2,34,000</u>

- i. Indicate assertions in respect of transactions and events for the period relating to PPE.
- ii. State specific assertions relating to the above extract of financial statement.
[MTP NOV 2021]

Answer:

- i. **Assertions about transactions and events for the period relating to PPE:**
 1. Occurrence—transactions and events relating to PPE have been recorded, have occurred and pertain to the entity.
 2. Completeness—all transactions and events relating to PPE that should have been recorded have been recorded.
 3. Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.
 4. Cut-off—transactions and events have been recorded in the correct accounting period.
 5. Classification—transactions and events have been recorded in the proper accounts.
- ii. **The specific assertions are as follows:**
 1. the firm owns the plant and machinery;
 2. the historical cost of plant and machinery is Rs. 4 lacs;
 3. the plant and machinery physically exists;
 4. the asset is being utilised in the business of the company productively;

5. total charge of depreciation on this asset is Rs. 1,66,000 to date on which Rs. 26,000 relates to the year in respect of which the accounts are drawn up; and
6. the amount of depreciation has been calculated on recognised basis and the calculation is correct.

Question: You are an auditor of PQR Ltd. which has spent Rs. 10 lakhs on Research activities of the product during period under audit. Board of Directors want to recognize it as an internally generated intangible asset. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements. [MTP MAY 2021]

Answer: No Intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research shall be recognised as an expense when it is incurred since in the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Thus, board of directors of PQR Ltd cannot recognize the expense as internally generated intangible asset.

An intangible asset shall be recognised if, and only if:

- i. the said asset is identifiable;
- ii. the entity controls the asset i.e. the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits;
- iii. it is probable that future economic benefits associated with the asset will flow to the entity;
- iv. the cost of the item can be measured reliably.

Question: From the auditing point of view, the auditor should verify that a proper disclosure about contingent liabilities is made in financial statements as required by AS 29. What type of disclosures should be made for each class of contingent liability as at the balance sheet date? [MTP MAY 2021]

Answer: Disclosure for each class of Contingent Liability: From the auditing point of view, the auditor should verify that a proper disclosure about contingent liabilities

is made in financial statement as required by AS 29. As per, AS 29 an enterprise should disclose for each class of contingent liability at the balance sheet date.

- i. A brief description of the nature of the contingent liability and where practicable.
- ii. An estimate of the amount as per measurement principle as prescribed for provision in AS 29.
- iii. Indication of the uncertainty relating to outflow.
- iv. The possibility of any reimbursement.

Where any of the information as required above is not disclosed because it is not practicable to do so, that fact should be stated.

Question: Name the assertions for the following audit procedures:

- i. Year end inventory verification.
- ii. Depreciation has been properly charged on all assets.
- iii. The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
- iv. All liabilities are properly recorded in the financial statements.
- v. Related party transactions are shown properly. [MTP MAY 2021]

Answer:

- i. Year end inventory verification: Existence Assertion.
- ii. Depreciation has been properly charged on all assets: Valuation Assertion.
- iii. Title deeds of the lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
- iv. All liabilities are properly recorded in the financial statements: Completeness.
- v. Related party transactions are shown properly: Presentation & Disclosure.

Question: Expenses which are essentially of a revenue nature if incurred for creating an asset or adding to its value for achieving higher productivity are regarded as expenses of a capital nature. Describe any six such expenses. [MTP MAY 2021]

Answer: Expenses which are essentially of a Revenue Nature, if incurred for creating an asset or adding to its value for achieving higher productivity, are regarded as expenditure of a capital nature. Examples of capital expenditure are-

- i. Material and wages- capital expenditure when expended on the construction of a building or erection of machinery.
- ii. Legal expenses- capital expenditure when incurred in connection with the purchase of land or building.
- iii. Freight- capital expenditure when incurred in respect of purchase of plant and machinery.
- iv. Repair- Major repairs of a fixed asset that increases its productivity.
- v. Wages- Wages paid on installation costs incurred in Plant & machinery.
- vi. Interest- Interest paid for the qualification period as per AS-16 i.e. before the asset is constructed.

Whenever, therefore, a part of the expenditure, ostensibly of a revenue nature, is capitalised it is the duty of the auditor not only to examine the precise particulars of the expenditure but also the considerations on which it has been capitalised.

Question: From the auditing point of view, the auditor should verify that a proper disclosure about contingent liabilities is made in financial statements as required by AS 29. What type of disclosures should be made for each class of contingent liability as at the balance sheet date? [MTP MAY 2021]

Answer: Disclosure for each class of Contingent Liability: From the auditing point of view, the auditor should verify that a proper disclosure about contingent liabilities is made in financial statement as required by AS 29. As per, AS 29 an enterprise should disclose for each class of contingent liability at the balance sheet date.

- i. A brief description of the nature of the contingent liability and where practicable.
- ii. An estimate of the amount as per measurement principle as prescribed for provision in AS 29.
- iii. Indication of the uncertainty relating to outflow.
- iv. The possibility of any reimbursement.

Where any of the information as required above is not disclosed because it is not practicable to do so, that fact should be stated.

Question: You are an auditor of PQR Ltd. which has spent ` 50 lakhs on Research activities of the product during period under audit, Board of Directors want to recognize it as an internally generated intangible assets. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements. [MTP NOV 2020]

Answer: No Intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research shall be recognised as an expense when it is incurred since in the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Thus, board of directors of PQR Ltd cannot recognize the expense as internally generated intangible asset.

An intangible asset shall be recognised if, and only if:

- i. the said asset is identifiable;
- ii. the entity controls the asset i.e. the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits;
- iii. it is probable that future economic benefits associated with the asset will flow to the entity;
- iv. the cost of the item can be measured reliably.

Question: BNP Ltd has reduced its Share Capital to a greater extent in the year for which you are conducting the audit. State how will you proceed for verifying the reduction of Capital. [MTP NOV 2020]

Answer: Reduction of Capital

For verifying reduction of capital, the auditor needs to undertake the following procedures:

- i. Verify that the meeting of the shareholders held to pass the special resolution was properly convened and that the proposal was circularized in advance to all the shareholders;

- ii. Verify that the Articles of Association authorises reduction of capital;
- iii. Examine the order of the Tribunal confirming the reduction and verify that a copy of the order and the minutes have been registered and filed with the Registrar of Companies;
- iv. Check the Registrar's Certificate as regards to reduction of capital;
- v. Vouch the accounting entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also check whether the requirements of Schedule III, Part I, have been complied with in relation to presentation;
- vi. Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet;
- vii. Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled;
- viii. Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
- ix. Verify that the Memorandum of Association of the company has been suitably amended.

Question: Proceedings have been initiated against False Limited for holding benami property under law relating to prohibition of benami transactions and the rules made thereunder but such property is not recorded in books of accounts. As a consultant to the company, what will you advise the company as far as disclosure requirements are concerned in financial statements in relation to said proceedings?
[RTP MAY 2024]

Answer: Disclosure in case of Benami Properties held by the Company: Where any proceedings have been initiated or pending against the company for holding any benami property under the relevant law relating to prohibition of such transactions, the company shall disclose the following: -

- (a) Details of such property, including year of acquisition
- (b) Amount thereof

- (c) Details of Beneficiaries
- (d) If property is not in the books, then the fact shall be stated with reasons
- (e) Where there are proceedings against the company under this law as a better of the transaction or as the transferor, then the details shall be provided
- (f) Nature of proceedings, status of same and company's view on same

Question: Droma Shoes Private Limited was established in year 2022-23 for manufacturing of footwear. As funds were needed to carry on its business activities - including for purchase of different raw materials, incurring of regular expenses like power and fuel and payment of wages etc., it had got sanctioned a credit facility amounting to Rs.2 crores repayable on demand from a bank against primary security of its current assets and collateral security of residential house of one of its directors. Duly signed guarantee documents by directors in favour of bank also form part of bank's loan documentation. Account statement of above facility downloaded from bank's website shows debit balance of Rs.1.85 crores as on 31st March, 2023. The operations in above credit facility are satisfactory. In this regard: -

1. Identify nomenclature of such credit facility given by banks. How would above amount of Rs.1.85 crores be reflected and classified in financial statements of company as on 31.3.23?
2. Also state specific disclosure requirements of Schedule III of Companies Act, 2013 in relation to above. [RTP MAY 2024]

Answer:

- I. The type of credit facilities referred to in above situation given by banks to meet working capital requirements of business which are repayable on demand are known as "cash credit facilities/overdraft" facilities. The amount of ` 1.85 crores outstanding as on 31st March, 2023 reflects borrowings of the company and it would be classified as "short-term borrowings" as loans repayable on demand from banks under current liabilities in balance sheet of the company. Borrowings shall further be subclassified as secured.
- II. Specific disclosure requirements of short-term borrowings under Schedule III to Companies Act, 2013 in given situation are as under:-
 - a. Nature of security i.e. primary security of current assets and

collateral security of residential house belonging to a director shall be specified.

- b. As loans have been guaranteed by directors, the aggregate amount of such loans shall be disclosed.

To be disclosed as Additional Regulatory Information

Since the Company has borrowings from bank on the basis of security of current assets, it shall also disclose the following :-

- a. whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts.
- b. if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

Question: Following is extract of notes to accounts of financial statements of STU Private Limited listing some ratios. Discuss, whether disclosure, given in following manner meets requirements of Schedule III of the Companies Act, 2013. Ignore other ratios which are not listed in extract given below:

Name of ratio	31.3.2023	31.3.2022
Current ratio	2.50	2.30
Inventory turnover ratio	3.00	6.00
Trade receivables turnover ratio	1.75	5.00
Net profit ratio (in%)	13%	10%

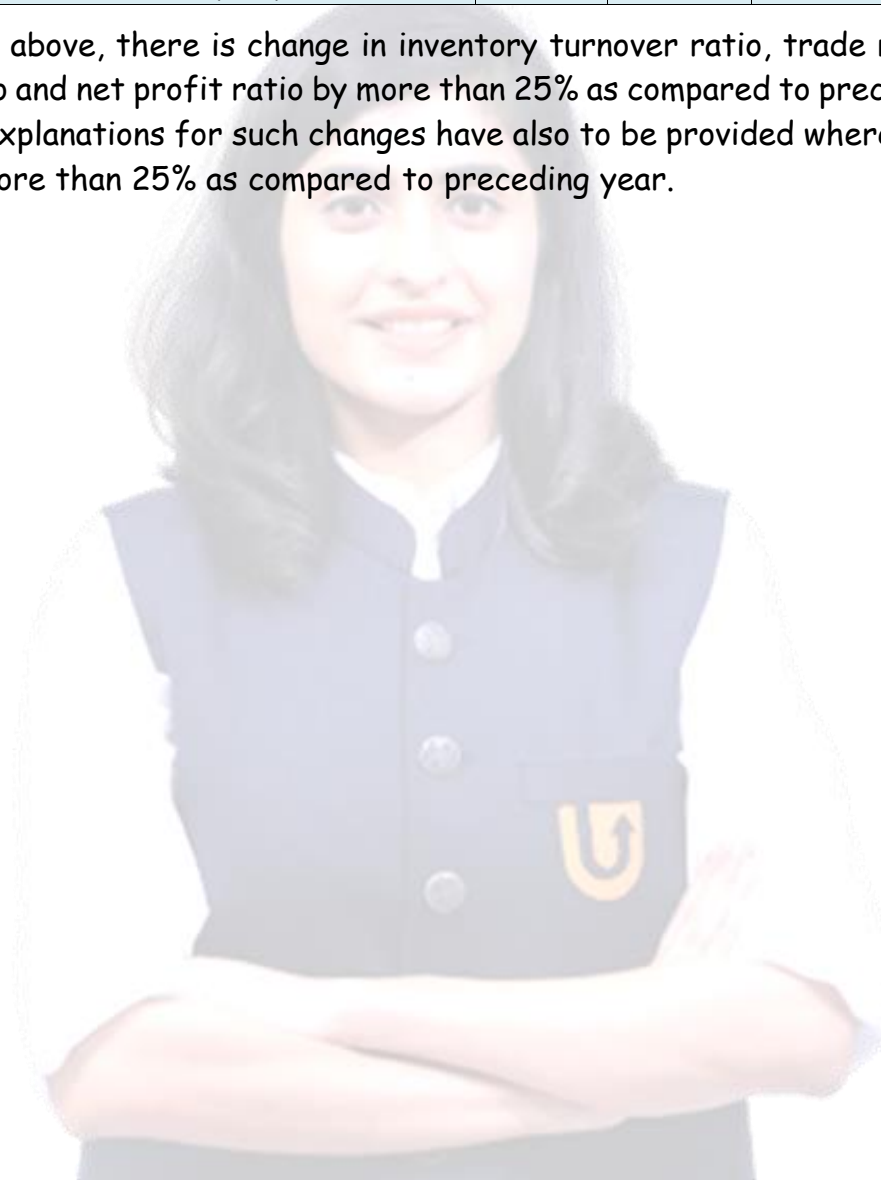
Answer: The disclosure given in the question does not meet requirements of Schedule III to Companies Act, 2013.

Schedule III requires that the company shall explain the items included in numerator and denominator for computing the ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

In the given table, the company has not explained the items included in numerator and denominator for computing ratios. Further, variations in ratios as compared to preceding year are as under: -

Name of ratio	31.3.23	31.3.22	Variation
Current ratio	2.50	2.30	8.69%
Inventory turnover ratio	3.00	6.00	50%
Trade receivables turnover ratio	1.75	5.00	65%
Net Profit ratio (in%)	13%	10%	30%

As calculated above, there is change in inventory turnover ratio, trade receivables turnover ratio and net profit ratio by more than 25% as compared to preceding year. Therefore, explanations for such changes have also to be provided where there are changes by more than 25% as compared to preceding year.



Chapter-6: Audit Documentation

Question 1: Audit documentation provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements. Explain stating clearly purpose of audit documentation. (MTP 5 Marks 2018 & Oct 2018)

OR

Audit documentation serves a number of purposes. List such purposes. (MTP 3 Marks March 2021)

OR

A new team member of GSR & Co., the auditors of Esteem Limited, was of the view that Audit Documentation would not serve any purpose at any stage of Audit. Explain. (RTP May 2021)

OR

SA 230, "Audit Documentation" deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. Such audit documentation serves various purposes. Explain. (RTP May 2023)

OR

Discuss any two purposes of audit documentation. (Study Mat)

OR

CAM is the engagement partner of S Ltd. He has instructed his audit team to maintain proper audit documentation. The audit team members are not sure about the purpose for which the documentation should be made. Explain the various purposes of audit documentation with reference to SA 230. (3 Marks Nov 2022)

Answer 1: Audit documentation: SA 230 on "Audit Documentation", audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as "working papers" or "work papers" are also sometimes used.) **Nature of Audit Documentation**
Audit documentation provides:

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

Purpose of Audit Documentation

The following are the purpose of Audit documentation:

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections.
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

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

Question 2: Discuss with reference to SA-230, factors affecting form, contents and extent of audit documentation. (MTP 4 Marks April 2019)

OR

The form, content and extent of audit documentation depend on factors such as the size and complexity of the entity, the nature of the audit procedures to be performed etc. Explain in detail. (RTP Nov 2018)

Answer 2: Form, Content and Extent of Audit Documentation: Working papers should record the audit plan, nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.

The form, content and extent of working papers depend on factors such as:

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

Question 3: "Completion Memorandum" is helpful as part of the audit documentation. Explain. (MTP 3 Marks May 2020, 3 Marks, May 2019)

Answer 3: Completion Memorandum or Audit Documentation Summary.

The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-

- i. the significant matters identified during the audit.
- ii. how they were addressed.

Such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist auditor's consideration of the significant matters. It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

Question 4: An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Explain stating clearly the examples of significant matters. (RTP Nov 2020).

Or

Judging the significance of a matter requires an objective analysis of the facts and circumstances. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Explain with the help of examples. (RTP May 2019)

Answer 4: Documentation of Significant Matters and Related Significant Professional Judgments Judging the significance of a matter requires an objective analysis of the facts and circumstances. **Examples of significant matters include:**

- Examples of significant matters include:
 1. Matters that give rise to significant risks (as defined in SA 315).
 2. Results of audit procedures indicating
 - a. That the financial statements could be materially misstated
 - b. A need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
 3. Circumstances that cause the auditor significant difficulty in applying

necessary audit procedures.

4. Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.
- An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgement exercised in performing the work and evaluating the results.
 - Documentation of the professional judgements made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgement.

Question 5: The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. Explain with the help of examples. (RTP Nov 2020)

Answer 5: The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.

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

Question 6: While documenting the nature, timing and extent of audit procedures performed in case of audit of PQR Ltd, explain the important matters its auditor should record. (RTP May 2021)

Answer 6: In documenting the nature, timing and extent of audit procedures performed, the auditor of PQR Ltd shall record:

- i. The identifying characteristics of the specific items or matters tested.
- ii. Who performed the audit work and the date such work was completed; and Who reviewed the audit work performed and the date and extent of such review?

Question 7: The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand significant matters arising during the audit. Explain the above statement and also give examples of significant matters. (RTP Nov 2022)

Answer 7: The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

- Matters that give rise to significant risks.
- Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
- Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.

Question 8: Audit Documentation refers to the record of three items. Explain stating clearly the objective and nature of audit documentation. (RTP Nov 2023)

Answer 8: Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

The objective of the auditor is to prepare documentation that provides:

- i. A sufficient and appropriate record of the basis for the auditor's report; and
- ii. Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Nature of Audit Documentation Audit documentation provides:

- a. Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- b. Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Question 9: The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis. Explain in detail. (RTP Nov 2023, May 2023)

Answer 9: The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

- SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
- An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.
- Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.

Examples of such changes include:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
- After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.
- SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

Chapter-7: Completion and Review

Question: Financial Statement may be affected by certain events that occur after the date of Financial Statements. How financial reporting frameworks specifically refer to such events, explain giving examples.

Answer: Financial reporting frameworks ordinarily identify two types of events

- (a) Those that provide evidence of conditions that existed at the date of the financial statements
- (b) Those that provide evidence of conditions that arose after the date of the financial statements

Examples of events providing evidence of conditions that existed at the date of the financial statements

1. Declaration of insolvency of a major debtor of the entity between the date of financial statements and the date of auditor's report providing evidence on the recoverability of the money due from debtor as on date of the financial statements.
2. Settling a legal claim outside the court at a reduced amount between the date of financial statements and the date of auditor's report for which provision has already been made in financial statements. It provides evidence on adjustment in provision amount already made in financial statements, if any.

Examples of events providing evidence of conditions that arose after the date of the financial statements

1. Issue of new share capital.
2. Planned merger of the company.
3. Destruction of substantial inventories due to fire between the date of the financial statements and the date of auditor's report.

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

Also explain how would the auditor proceed if such an assessment has not yet been performed by the management. [RTP -MAY 2021]

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

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

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

Question: Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. Explain. Also discuss the objectives of an auditor regarding Going concern as per relevant standard on auditing.

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

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

- i. intends to liquidate the entity or to cease operations,
- ii. or has no realistic alternative but to do so

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

and discharge its liabilities in the normal course of business.

The objectives of the auditor regarding Going Concern are:

1. To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.
2. To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and
3. To report in accordance with this SA.

Question: While doing audit of ABC Pvt Ltd, on the basis of sufficient and appropriate evidence, auditor comes to a conclusion that use of the Going Concern Basis of Accounting is appropriate, but a material uncertainty exists. Discuss the implications for auditor's report if:

- A. Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements.
- B. Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements. [RTP -NOV 2021]

Answer: Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists

The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

- A. Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern."

- B. Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements.

If adequate disclosure about the material uncertainty is not made in the

financial statements, the auditor shall:

- a. Express a **qualified opinion or adverse opinion**, as appropriate, in accordance with SA 705 (Revised); and
- b. In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Question: Give examples of financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. [RTP -NOV 2021]

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

1. Net liability or net current liability position.
2. Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
3. Indications of withdrawal of financial support by creditors.
4. Negative operating cash flows indicated by historical or prospective financial statements.
5. Adverse key financial ratios
6. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
7. Arrears or discontinuance of dividends
8. Inability to pay creditors on due dates
9. Inability to comply with the terms of loan agreements
10. Change from credit to cash-on-delivery transactions with suppliers Inability to obtain financing for essential new product development or other essential investments.

Question: SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Explain those events and also define subsequent events. [RTP -NOV 2021]

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

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

- a. Those that provide evidence of conditions that existed at the date of the financial statements; and
- b. Those that provide evidence of conditions that arose after the date of the financial statements.

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

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

Question: The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. With reference to SA 560, what are the audit procedures included in the auditor's risk assessment? [JULY 2021]

Answer: The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

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

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

- a. Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- b. Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- c. Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- d. Reading the entity's latest subsequent interim financial statements, if any.

Question: CA K is re-appointed as the auditor of B Ltd. He wants to re-confirm certain matters and has asked the management to give written representations for the same. Under what circumstances can an auditor ask the management to reconfirm its acknowledgement and understanding of responsibilities in written representation? [DEC 2021]

Answer: Other Written Representation: Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations.

The written representations draw on the agreed acknowledgement and understanding of management of its responsibilities by requesting confirmation that it has fulfilled them. **The auditor, CA K of B Ltd, may also ask management of B**

Ltd to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when:

1. Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities.
2. The terms of the audit engagement were prepared in a previous year;
3. There is any indication that management misunderstands those responsibilities;
or
4. Changes in circumstances make it appropriate to do so

Question: Explain the objectives of the auditor regarding written representations. [JAN 2021]

Answer: The objectives of the auditor regarding written representation:

1. **To obtain written representations:** To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor.
2. **To support other evidence:** To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and
3. **To respond appropriately:** To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

Question: Management's assessment of the entity's ability to continue as a going concern involves making a judgement about inherently uncertain future outcomes of events or conditions. What are relevant factors to that judgement? [JAN 2021]

Answer: Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are relevant to that judgment:

- The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the

outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.

- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

Question: Give examples of operating events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

Answer: Examples of operating events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern are as follows:

- Management intentions to liquidate the entity or to cease operations
- Loss of key management without replacement
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
- Labour difficulties
- Shortages of important supplies
- Emergence of a highly successful competitor

Question: If management does not provide one or more of the requested written representations, the auditor shall do what?

Answer: If management does not provide one or more of the requested written representations, the auditor shall: -

- a. Discuss the matter with management
- b. Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations and audit evidence in general; and
- c. Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705 having regard to the requirement of disclaimer of opinion.

Question: Who are “Those Charged With Governance”?

Answer: The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.

- This includes overseeing the financial reporting process.
- Governance structures vary by entities, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.
- For example, in some entities, a supervisory board exists that is separate from executive board. In other entities, both supervisory and executive functions are performed by a single board.
- In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure. For example, company directors.
- In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
- In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee.
- Also, in some cases, the appropriate persons with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family- owned entities and some not-for-profit organizations.

In such cases, the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate.

Question: What is the objectives of the auditor as per SA 260 “SIGNIFICANCE OF COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE”?

Answer: The objectives of the auditor are:-

- a. To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit
- b. To obtain from those charged with governance information relevant to the audit

- c. To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and
- d. To promote effective two-way communication between the auditor and those charged with governance.

Question: The auditor shall communicate with those charged with governance, what are the significant findings from the audit communicated as per SA 260?

Answer: The auditor shall communicate with those charged with governance:

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

Question: Give examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency?

Answer: The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.

- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The importance of the controls to the financial reporting process, for example:
 - General monitoring controls (such as oversight of management).
 - Controls over the prevention and detection of fraud.
 - Controls over the selection and application of significant accounting policies.

- Controls over significant transactions with related parties.
- Controls over significant transactions outside the entity's normal course of business.
- Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
- The interaction of the deficiency with other deficiencies in internal control.

Question: Give examples of indicators of significant deficiencies in internal control as per SA 265?

Answer:

- Evidence of ineffective aspects of the control environment, such as: -
 - Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
 - Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
 - Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- Evidence of management's inability to oversee the preparation of the financial statements.

Question: Facts which becomes known to the auditor after the date of the auditor's report but before the date the financial statements are issued, What shall the auditor do, When law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events to that amendment.

Answer:

In such cases, the auditor shall either

A

Amend the auditor's report

- to include an additional date restricted to that amendment that thereby indicates
- that the auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements described in the relevant note to the financial statements

B

Provide a new or amended auditor's report that includes

- a statement in an Emphasis of Matter paragraph or Other Matter(s) paragraph
- that conveys that auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

Question: CA K is statutory auditor of DEMA Private Limited for the year 2022-23. The company has three plants in India. He is nearing completion of audit procedures relating to financial statements for the year under audit and has yet to sign audit report. Meanwhile, a huge fire had broken out in one of plants of the company located near Nashik on 25th June, 2023 damaging substantial part of machinery and work-in-process resulting in loss of about Rs.5 crores. Unaware of the incident, he is in process of finalizing his report in first fortnight of July 2023. State few audit procedures to be performed by him to obtain sufficient appropriate evidence for identifying such events. Also explain auditor's responsibilities in this situation. [RTP May 2024]

Answer: In the given situation, a huge fire had broken out in one of plants of company on 25th June, 2023 destroying substantial part of machinery and work-in-process resulting in loss of Rs.5 crores. The auditor has yet to sign audit report.

Before signing audit report, he should perform following audit procedures to obtain sufficient appropriate audit evidence that all such events have been identified and are appropriately reflected in financial statements: -

- Inquiry of management whether any subsequent events have occurred
- Reading minutes of the meetings of owners, management that have been held after date of financial statements and inquiring about matters discussed at such meetings for which minutes are not available.
- Reading entity's latest subsequent interim financial statements
- Obtaining Written representations from management in accordance with SA 580

The situation is an example of subsequent event occurring between date of financial statements and date of audit report requiring disclosure in financial statements. The auditor has a responsibility to obtain sufficient appropriate audit evidence whether such an event requiring disclosure in financial statements is appropriately reflected in financial statements.

Question: Kundan, a CA student, is part of an engagement team conducting audit of an entity. The audit procedures are nearing completion. He notices that engagement partner has asked for a cash flow forecast from management for next twelve months from date of financial statements. Keeping in view above, answer the following:-

1. Discuss likely purpose of engagement partner in the above situation. Elaborate upon significance of such testing being performed by engagement partner.
2. State any two audit procedures in relation to cash flow forecast likely to be performed by engagement partner. [RTP May 2024]

Answer: In the given situation, the engagement partner has asked for a cash flow forecast from management for next twelve months from date of financial statements. The audit procedures are also nearing completion.

Therefore, purpose of engagement partner in requiring a cash flow forecast is to obtain sufficient appropriate audit evidence regarding and to conclude on appropriateness of management's use of going concern basis of accounting in preparation of its financial statements. Further, his purpose is also to conclude on basis of audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast a significant doubt on ability to entity to continue as a going concern, and to report in accordance with SA 570.

The significance of testing going concern assumption is due to its effect on preparation of financial statements. When the use of going concern is considered as appropriate, assets and liabilities are recorded on the basis that entity will be able to realize its assets and discharge liabilities in normal course of business. In case it is not so viewed, financial statements are prepared on liquidation basis. Hence, testing such an assumption provides evidence to auditor whether use of such assumption is appropriate or not.

Two audit procedures in relation to cash flow forecast likely to be performed

- Evaluate reliability of underlying data generated to prepare the forecast
- Determine whether there is adequate support for assumptions underlying the forecast.



Chapter-8: Audit Report

Question 1: Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. [RTP -NOV 2022]

Answer 1: Examples of circumstances to include Emphasis of Matter Paragraph: As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs in The Independent Auditor's Report", the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are;

- a. An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- b. A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- c. Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- d. A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Question 2: While drafting auditor's report of LK Ltd., what are the matter to be included by auditor in Opinion Section paragraph? [RTP -NOV 2022]

Answer 2: The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion".

Opinion Section of the Auditor's report shall also:

- i. Identify the entity whose financial statements have been audited;
- ii. State that the financial statements have been audited;
- iii. Identify the title of each statement that comprises the financial statements;
- iv. Refer to the summary of significant accounting policies and other explanatory information; and
- v. Specify the date or period covered by each financial statement comprising the financial statements.

Question 3: When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700. Explain [RTP - MAY 2022]

Answers 3: When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- a. A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- b. A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements and
- c. The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

Question 4: As an auditor of listed company, what are the matters that the auditor should keep in mind while determining "Key Audit Matters". [RTP -NOV 2021]

Answer 4: Determining Key Audit Matters: As per SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report", the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- i. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
- ii. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- iii. The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the

current period and therefore are the key audit matters.

Question 5: Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2020-21 the company transferred its accounts to computerised system (SAP) from manual system of accounts. Since the employees of the company were not well versed with the SAP system, there were many errors in the accounting during the transition period. As such the statutory auditors of the company were not able to extract correct data and reports from the system. Such data was not available manually also. Further, the employees and the management of the company were not supportive in providing the requisite information to the audit team. The auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

Explain the kind of audit report that the statutory auditor of the company should issue in this case. [RTP -NOV 2021]

Answer 5: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to

form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

In the present case Delightful Ltd, the statutory auditor of the company is unable to extract correct data and reports from the SAP system for conduct of audit. Also, such data and reports are not available manually. Moreover, the auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

As such, the statutory auditor of Delightful Ltd. should give a disclaimer of opinion.

Question 6: The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally. Explain. [RTP -MAY 2021]

Answer 6: The requirements of SA 700 are aimed at addressing an appropriate

balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users. This SA promotes consistency in the auditor's report but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions.

Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

Question 7: The senior member of the firm Kaur & Associates, Chartered Accountants, informed to its auditing staff that at the time of audit reporting regarding corresponding figures, when corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in specified circumstances. What are those exceptional circumstances? [MAY 2022]

Answer 7: Audit reporting Regarding Corresponding Figures:

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

1. **the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion** and the **If** matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the **Basis for Modification** paragraph in the auditor's report, the auditor shall either:
 - a. Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
 - b. In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
2. **If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements** on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an

adverse opinion in the auditor's report on the current period financial statements, modified.

3. **Prior Period Financial Statements Not Audited-** If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

Question 8: M/s S & Associates are the Statutory Auditors of Real Ltd., a company engaged in the business of manufacturing of garments. The auditor has completed the audit and is in the process of forming an opinion on the financial statements for the F.Y. 2020-2021. CA K, the engagement partner, wants to conclude that whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. What factors he should consider to reach that conclusion? [DEC 2021]

Answer 8: Factors to be considered to form an opinion:

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- a. The auditor's conclusion, in accordance with SA 330, whether sufficient appropriate audit evidence has been obtained
- b. The auditor's conclusion, in accordance with SA 450, whether uncorrected misstatements are material, individually or in aggregate.
- c. The evaluations required
 - i. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.
 - ii. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Question 9: If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, what is required to be stated by the auditor in an Other Matter paragraph. [MTP NOV 2022]

Answer 9: If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:

- i. That the financial statements of the prior period were audited by a predecessor auditor
- ii. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and
- iii. The date of that report, unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.

Question 10: What is meant by Emphasis of Matter Paragraph? Give some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. [MTP NOV 2022]

Answer 10: Emphasis of Matter Paragraph is a paragraph included in the auditor's report that refers to a matter appropriately presented and disclosed in the financial statements that in the auditor's judgment, is of such importance that it is fundamental to the user's understanding of the financial statements.

Some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph.

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Questions 11: Discuss the reporting requirements regarding statutory dues and Internal Audit as per CARO, 2020. [NOV 2022]

Answer 11: Matters to be included as per CARO, 2020:

Statutory dues Clause (vii)

- a. whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;
- b. where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);

Internal Audit Clause (xiv)

- a. whether the company has an internal audit system commensurate with the size and nature of its business.
- b. whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor;

Question 12: State the matters to be included in auditor's report as per CARO, 2020 regarding "Default in repayment of loan or borrowing to a financial institution, bank etc." [MTP NOV 2022]

Answer 12: The auditor is required to report as per clause (ix) of paragraph 3 of CARO 2020

- a. whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:-

Nature of Borrowing including debt Securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks if any

	Lender wise details to be provided in case of defaults to banks, financial institutions And Government.				
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- b. whether the company is a declared wilful defaulter by any bank or financial institution or other lender
- c. whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported
- d. whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;
- e. whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised.

Question 13: State the matters to be included in auditor's report as per CARO, 2020 regarding - Verification of inventory and working capital limits. [MTP MAY 2022]

Answer 13: Matters to be included in Auditor's report as per CARO 2020:

Clause (ii) of Para 3 of CARO, 2020, requires the auditor to report

- a. whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;
- b. whether during any point of time of the year, the company has been sanctioned

working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

Question 14: The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Explain stating the advantages of the joint audit. [MTP MAY 2023]

Answer 14: Joint Audit: The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage.

In specific terms the **advantages** that flow may be the following:

- a. Sharing of expertise
- b. Advantage of mutual consultation
- c. Lower workload
- d. Better quality of performance
- e. Improved service to the client
- f. Displacement of the auditor of the company taken over in a takeover often obviated
- g. In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations
- h. Lower staff development costs
- i. Lower costs to carry out the work
- j. A sense of healthy competition towards a better performance

Question 15: Mention some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. [RTP May 2024]

Answer 15: Examples of circumstances to include Emphasis of Matter Paragraph:

As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:-

- a. An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- b. A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- c. Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- d. A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Question 16: CA. S, while conducting audit of an entity is facing the following issues: -

- i. He has not been provided with necessary support for attending inventory count process of entity as at year end.
- ii. Accounts Manager is not providing him present addresses of customers as well as suppliers for sending external confirmations. Even mail ids have not been provided on the pretext of business confidentiality.
- iii. He was not able to verify revenues of entity due to lack of complete details.
- iv. He has been asking for bills on a sample basis for the purpose of verifying expenses, but staff has been making lame excuses.

The matter was brought to knowledge of higher management, but of no avail. The auditor, CA S has come to the conclusion that the possible effects on the financial statements of undetected misstatements would be material and affecting many aspects of financial statements and in such a case, a qualification of the opinion would be inadequate to communicate the gravity of the situation.

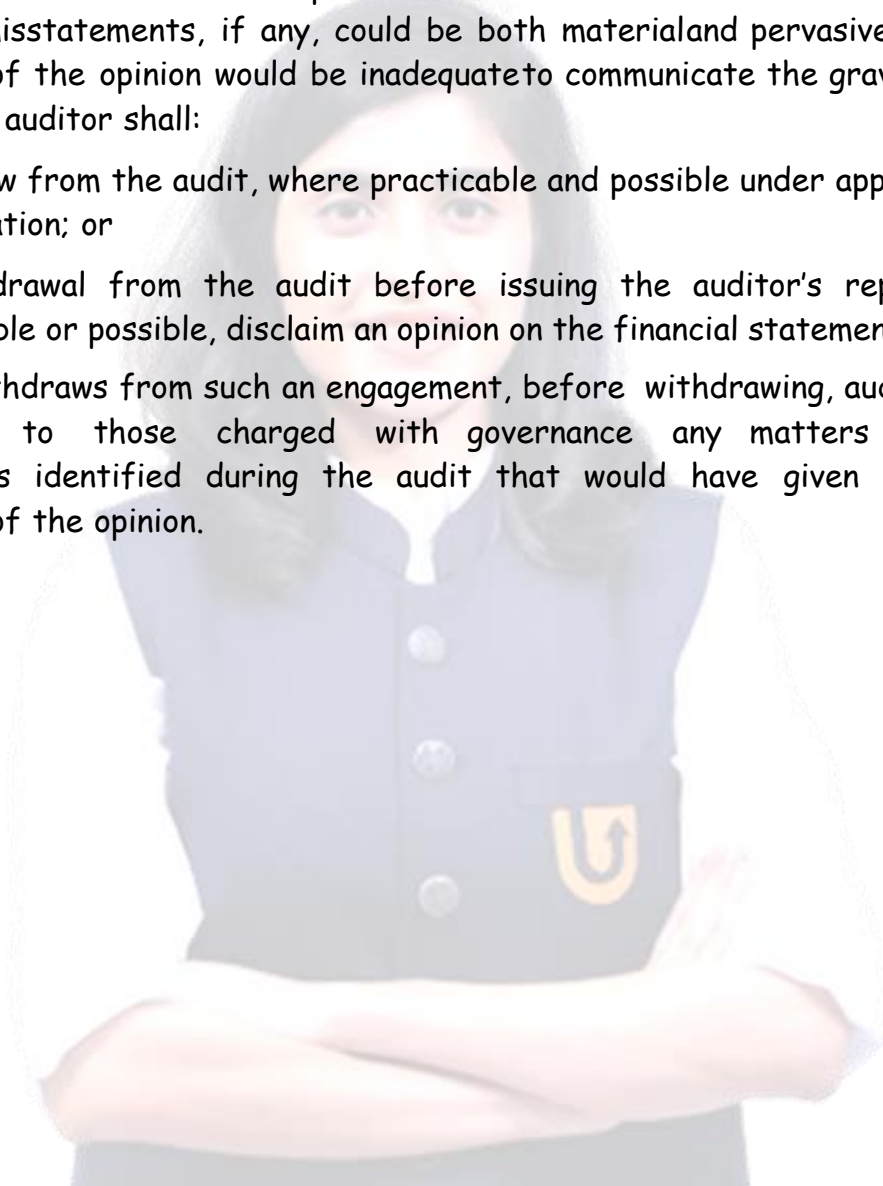
How should the auditor proceed in such a situation?

Answer 16: In the given case, auditor has not been able to obtain sufficient appropriate audit evidence relating to inventories, debtors, creditors, revenues and expenses. The matter was brought to the knowledge of management but no result has been achieved. In such circumstances, auditor should proceed as given here under: -

If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

- (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or
- (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

If auditor withdraws from such an engagement, before withdrawing, auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.



Chapter-9: Special Features of Audit of Different Type of Entities

Question 1: Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession. Explain stating clearly the definition of Government auditing as discussed in U.N. Handbook on Govt Auditing and Developing Countries and also state Objectives of Govt audit. [RTP -MAY 2021]

Answer 1: Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession.

The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows :

Government auditing is

- the objective, systematic, professional and independent examination
- of financial, administrative and other operations
- of a public entity
- made subsequently to their execution
- for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions
- by the responsible officials
- and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

OBJECTIVES :-

- a) Accounting for Public Funds:-Government audit serves as a mechanism or process for public accounting of government funds.
- b) Appraisal of Government policies:-It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
- c) Base for Corrective actions:-Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.

Question 2: Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end. Explain [RTP -MAY 2021]

Answer 2: Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end. The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration. In India, the function of Government Audit is discharged by the independent statutory authority of the **Comptroller and Auditor General** through the agency of the **Indian Audit and Accounts**

Department. Audit is a necessary function to ensure accountability of the executive to Parliament, and within the executives of the spending agencies to the sanctioning or controlling authorities. The purpose or objectives of audit need to be tested at the touchstone of public accountability. The Comptroller and Auditor General (C&AG), in the discharge of his functions, watches that the various authorities act in regard to financial matters in accordance with the Constitution and the laws made by Parliament, and conform to the rules or orders made thereunder.

Question 3: The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. Explain stating important objectives of audit of such bodies. [RTP - NOV 2021]

Answer 3: The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts.

However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

The important objectives of audit are:

- a. reporting on the fairness of the content and presentation of financial statements;
- b. reporting upon the strengths and weaknesses of systems of financial control;
- c. reporting on the adherence to legal and/or administrative requirements;
- d. reporting upon whether value is being fully received on money spent; and
- e. detection and prevention of error, fraud and misuse of resources.

Question 4: While planning the audit of an NGO, the auditor may focus on Knowledge of the NGO's work, its mission and vision, Updating knowledge of relevant statutes especially with regard to recent amendments, circulars etc. Explain the other relevant points the auditor needs to focus while planning the audit of NGO. [RTP -NOV 2021]

Answer 4: While planning the audit, the auditor may concentrate on the following:

- i. Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
- ii. Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.
- iii. Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
- iv. Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
- v. Examination of minutes of the Board/Managing Committee/Governing Body/ Management and Committees thereof to ascertain the impact of any decisions on the financial records.

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

Question 5: Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain. [RTP -MAY 2022]

Answer 5: Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations.

The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.

The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

Question 6: No inspection under Section 79 of Multi-State Co-operative Societies Act, 2002 shall be made unless a notice has been given to the multi-state co-operative society. Explain stating clearly when and how such inspection can be made. Also state the powers available with the Central Registrar in this regard along with provisions relating to communication of the inspection report under the said section. [RTP -MAY 2022]

Answer 6: Inspection of Multi-State Co-operative societies under Section 79

1. **When:** The Central Registrar may, on a request from

- i. federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or
 - ii. not less than one-third of the members of the board or
 - iii. not less than one-fifth of the total number of members of a Multi-State co-operative society
2. **How:** By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing in this behalf to make an inspection into the constitution, working and financial condition of a Multi-State co-operative society.
3. **Opportunity of Being heard:** No inspection shall be made unless a notice of not less than fifteen days has been given to the multi-state co-operative society.
4. **Powers available:** The Central Registrar or the person authorized by him shall have the following powers:
 - a. He shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of that society and may, in the event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.
 - b. Every officer or member of a Multi-State Co-operative society shall furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.
5. **Inspection Report:** A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection.

Question 7: You have been appointed as an auditor of ABC Hotel, a three star hotel, for Financial Year 2021-22. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages? [RTP -NOV 2022]

Answer 7: Verification of inventories in the nature of food and beverages: The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores' areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed. Therefore, following points may be noted in this regard:

- a. All movement and transfer of inventories must be properly documented.
- b. Areas where inventories are kept must be kept locked and the key retained by the departmental manager.
- c. The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
- d. Many hotels use specialized professional valuers to count and value the inventories on a continuous basis throughout the year.
- e. The auditor should ensure that all inventories are valued at the year end and that he should himself be present at the year-end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories.

Question 8: Cinescreen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets? [RTP - NOV 2022]

Answer 8: Audit of Cinema: The special steps involved in the audit of receipts from sale of tickets are stated below-

- i. Verify that entrance to the cinema-hall during show is only through printed tickets;
- ii. Verify that they are serially numbered and bound into books;
- iii. Verify that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
- iv. Verify that for advance booking a separate series of tickets is issued;

- v. Verify that the inventory of tickets is kept in the custody of a responsible official.
- vii. Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it. Verify that a record is kept of the 'free passes' and that these are issued under proper authority.
- viii. Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class.
- ix. Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.

Question 9: M/s T & Co. Chartered Accountants, a partnership firm, is appointed as an auditor of Treatment Hospital run by Smile Foundation, a charitable trust. Over and above the receipts of treatment of patients, during the year trust has received donations from various donors to treat COVID-19 patients and also incurred some capital expenditure for further development of the hospital. On some of the investment income, income tax has been deducted. What are the special points to be considered by M/s T & Co. while auditing such transactions of Treatment Hospital? [MAY 2022]

Answer 9: Audit of a Hospital:

A. Receipts from treatment of patients

1. **Register of Patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
2. **Collection of Cash from patients:** Check cash collections as entered in the Cash Book with the receipts counterfoils and other evidence for example, copies of patient's bills.

B. Donations from donors to treat the patients: Ascertain legacies and donation received for a specific purpose have been applied in the manner agreed upon.

- C. **Capital Expenditure Incurred:** Verify the Capital Expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee.
- D. **Where income-tax has been deducted from the Investment income,** it should be seen that a refund thereof has been obtained since charitable institutions are exempt from payment of Income-tax. This involves:
- vouching the Income-tax refund with the correspondence with the Income-tax Department; and
 - checking the calculation of the repayment of claims/refund claim.

Question 10: Local Fund Audit Wing of a State of a State Government has appointed you to audit the accounts of one of the Local body governed by it. As an auditor, what will be your reporting areas? [DEC 2021]

Answer 10: Reporting areas in audit of Local Fund:

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

The important objectives of audit are:

- reporting on the fairness of the content and presentation of financial statements;
- reporting upon the strengths and weaknesses of systems of financial control;
- reporting on the adherence to legal and/or administrative requirements;
- reporting upon whether value is being fully received on money spent; and
- detection and prevention of error, fraud and misuse of resources.

Question 11: In case of Government entities, audit of accounts of stores and inventories has been developed as a part of expenditure audit. Discuss about the duties and responsibilities entrusted to C&AG. [DEC 2021]

Answer 11: Audit of Accounts of Stores and Inventories in Government Companies:

Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted :-

- i. to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out.
- ii. to bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control.
- iii. to verify that the purchases are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority.
- iv. to ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit.
- v. to check the accounts of receipts, issues and balances regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

Question 12: CA A is appointed as the auditor of a charitable institutions. Discuss the audit procedure undertaken by him while auditing the Subscription and Donation received by the charitable institution. [DEC 2021]

Answer 12: Audit Procedure in audit of Subscriptions & donations:

Audit Procedure to be undertaken by CA A in respect of Subscriptions and donations received by a Charitable Institution is:

- i. Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.
- ii. Whether official receipts are issued;
 - a. confirming that adequate control is imposed over unused receipt books;
 - b. obtaining all receipt books covering the period under review;
 - c. test checking the counterfoils with the cash book; any cancelled receipts being specially looked into;
 - d. obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
 - e. examining the system of internal check regarding moneys received from box collections, flag days, etc. and checking the amount received from representatives, with the correspondence and the official receipts issued; paying special attention to the system of control exercised over collections and the steps taken to ensure that all collections made have been accounted for; and
 - f. verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

Question 13: Define Government Audit and explain its objectives. [JULY 2021]

Answer 13: Government auditing is

- the objective, systematic, professional and independent examination
- of financial, administrative and other operations
- of a public entity
- made subsequently to their execution
- for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions
- by the responsible officials

- and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

OBJECTIVES of Govt Audit are:

- Accounting for Public Funds:** Government audit serves as a mechanism or process for public accounting of government funds.
- Appraisal of Government policies:** It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
- Base for Corrective actions:** Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.
- Administrative Accountability:** The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration.

Question 14: Tomo Construction Engineering LLP approached CA K to understand various returns to be maintained and filed by them. Guide/Discuss the various returns to be maintained and filed by them. [JULY 2021]

Answer 14: Returns to be maintained and filed by an LLP:

- Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.
- Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months or the financial year to which the Statement of Account and Solvency relates.

Question 15: You have been appointed as internal auditor of 'City Club' in Delhi. The receipts of the club were 50 lakhs during the previous year ending 2019-20. You are required to mention special points of consideration while auditing such receipts of the club. [JAN 2021]

Answer 15: The special steps involved, to be considered by the Internal Auditor of City Club in conducting the audit of receipts of the club are stated below-

1. Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
2. Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
3. Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
4. Check totals of various columns of the Register of members and tally them across.
5. See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.
6. Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.

Question 16: You are appointed as an auditor of co-operative society. State the special features of the co-operative audit to be borne in mind by the auditor, concerning:

1. Audit classification of society.
2. Discussion of draft audit report with the management committee. [NOV 2020]

Answer 16:

- i. **Audit classification of society** - After a judgement of an overall performance of the society, the auditor has to award a class to the society. This judgement is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of

audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society. special services rendered, such as billiards, tennis, etc.

- ii. **Discussion of draft audit report with managing committee** - On conclusion of the audit, the auditor should ask the Secretary of the society to convene the managing committee meeting to discuss the audit draft report. The audit report should never be finalised without discussion with the managing committee. Minor irregularities may be got settled and rectified. Matters of policy should be discussed in detail.

Question 17: The audit of receipts of government is not as old as audit of expenditure but with the rapid growth of public enterprises audit of receipts tax or non-tax has come to stay. Discuss audit of receipts with respect to Government Audit. [NOV 2020]

Answer 17: Government auditing in India as elsewhere was primarily expenditure-oriented. Gradually, audit of receipts-tax and non-tax was taken up.

The audit of receipts is neither all pervasive nor as old as audit of expenditure but has come to stay in some countries. Such an audit provides for checking;

- i. whether all revenues or other debts due to government have been correctly assessed, realised and credited to government account by the designated authorities;
- ii. whether adequate regulations and procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection and proper allocation of cases;
- iii. whether such regulations and procedures are actually being carried out;
- iv. whether adequate checks are imposed to ensure the prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud or wilful omission or negligence to levy or collect taxes or to issue refunds; and
- v. review of systems and procedures to see that the internal procedures adequately secure correct and regular accounting of demands collection and

refunds and pursuant of dues up to final settlement and to suggest improvement. The basic principle of audit of receipts is that it is more important to look at the general than on the particular, though individual cases of assessment, demand, collection, refund, etc. Are important within the area of test check. A review of the judicial decisions taken by tax authorities is done to judge the effectiveness of the assessment procedure.

- vi. The extent and quantum of audit required to be done under each category of audit are determined by the C&AG. These are neither negotiable nor questioned. The prescribed extent and quantum of audit are structured in accordance with the design of test check, random sampling, general review, in-depth study of specified areas, etc. as may be warranted by the nature of transactions, its importance in the scheme of activities of a department and the totality of its transactions, the frequency of check and total plan of audit to be executed during a period.
- vii. Institutional mechanism provides for primary check by the auditor, test check by the supervisor and control and direction by the group leader. Planning, executing and reporting of work is directed and monitored at middle and top levels of the audit hierarchy. There are built-in arrangements within the C&AG to ensure that the work assigned to each employee is carried out as prescribed.
- viii. The audit is conducted both centrally where accounts and original vouchers are kept and locally where the drawing and disbursing functions are performed depending on the organisational and institutional arrangements obtaining.

Question 18: Explain the different types of revenue grants which local bodies may receive. [NOV 2020]

Answer 18: Local bodies may receive different types of grants from the state administration as well. Broadly, the revenue grants are of three categories:

- a. *General purpose grants:* These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.
- b. *Specific purpose grants:* These grants which are tied to the provision of certain services or performance of certain tasks.

- c. *Statutory and compensatory grants:* These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

Question 19: What is the function of audit while examining various rules, regulations and orders with regard to Audit against Rules & Orders by C&AG? [NOV 2020]

Answer 19: Audit against Rules & Orders - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made there under. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- a. they are not inconsistent with any provisions of the Constitution or any laws made there under;
- b. they are consistent with the essential requirements of audit and accounts as determined by the C&AG;
- c. they do not come in conflict with the orders of, or rules made by, any higher authority; and
- d. in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

Question 20: What is the function of audit while examining various rules, regulations and orders with regard to Audit against Rules & Orders by C&AG?

- i. Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined.

- ii. **The inventories in any hotel are both readily portable and saleable. Areas where large quantities of inventory are held should be kept locked. [RTP NOV 2020]**

Answer 20:

- i. **Internal control:** Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations. The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order. The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.
- ii. **Inventories:** The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed.

Areas where large quantities of inventory are held should be kept locked, the key being retained by the departmental manager. The key should be released only to trusted personnel and unauthorised persons should not be permitted in the stores areas except under constant supervision. In particular, any movement of goods in or

out of the stores should be checked. Many hotels use specialised professional valuers to take and value the inventories on a continuous basis throughout the year. Such a valuation is then almost invariably used as the basis of the balance sheet inventory figure at the year end. Although such valuers are independent of the audit client, it is important that the auditor satisfies himself that the amounts included for such inventories are reasonable. In order to satisfy himself of this, the auditor should consider attending the physical inventory taking and carrying out certain pricing and calculation tests. The extent of such tests could well be limited since the figures will have been prepared independently of the hotel.

Question 21: Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. These rules, regulations and orders against which regularity audit is conducted fall under various categories. Explain. [MTP NOV 2022]

Answer 21: Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. Audit of expenditure against regularity is of a quasi-judicial type of work performed by the audit authorities. It involves interpretation of the Constitution, statutes, rules, regulations and orders. The final power of interpretation of these, however, does not vest with the C&AG.

These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:

- i. Rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and the Contingency Fund of India or of a State);
- ii. Rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts of the Government of the India and of the States, and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and
- iii. Rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants.

Question 22: Explain the meaning of Government Audit and also discuss its objectives. [MTP NOV 2022]

Answer 22: The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows:

Government Audit is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity, made subsequently to their execution for the purpose of evaluating and verifying them, presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future action by the responsible officials and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

OBJECTIVES of the Govt Audit are:

1. Accounting for Public Funds: It serves as a mechanism or process for public accounting of government funds.
2. Appraisal of Govt. Policies: It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
3. Corrective Actions: Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.
4. Administrative Accountability: The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration.

Question 23: Explain and also state the role of auditor with respect to the following in case of a school:

- i. The fees from the students.
- ii. Other Receipts/Grants & Donations. [MTP NOV 2022]

Answer 23:

- i. Fee from Students :-

1. Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
2. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
3. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
4. Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
5. See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee.
6. Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
7. Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.

ii. **Other Receipts/Grants & Donations :-**

1. Verify rental income from landed property with the rent rolls, etc.
2. Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

3. Verify any Government or local authority grant with the memo of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons thereof.

Question 24: Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Explain those standards. [MTP MAY 2022]

Answer 24: Expenditure Audit: The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—

- i. that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against 'rules and orders'.
- ii. that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.
- iii. that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
- iv. that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.
- v. that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the performance audit.

Question 25: You have been appointed auditor of M/s. BLK Hospital. Discuss important points that would attract your attention while audit. [MTP MAY 2022]

Answer 25: AUDIT OF HOSPITAL

The important points involved in such an audit are stated below-

- i. **Register of patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- ii. **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For eg. copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills etc.
- iii. **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.
- iv. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- v. **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- vi. **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.
- vii. **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- viii. **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- ix. **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to

- ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- x. **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
 - xi. **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
 - xii. **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.
 - xiii. **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

Question 26: Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. Analyse and Explain. [MTP MAY 2022]

Answer 26: Audit against Rules & Orders - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:

- i. Rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and the Contingency Fund of India or of a State);
- ii. Rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts of the Government of the India and of the States,

and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and

- iii. Rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants.

Question 27: Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. Analyse and Explain. [MTP MAY 2022]

Answer 27: Audit against Rules & Orders - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:

- i. Rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and the Contingency Fund of India or of a State);
- ii. Rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts of the Government of the India and of the States, and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and
- iii. Rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry

out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- a. they are not inconsistent with any provisions of the Constitution or any laws made thereunder;
- b. they are consistent with the essential requirements of audit and accounts as determined by the C&AG;
- c. they do not come in conflict with the orders of, or rules made by, any higher authority; and
- d. in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

Audit of expenditure against regularity is of a quasi-judicial type of work performed by the audit authorities. It involves interpretation of the Constitution, statutes, rules, regulations and orders. The final power of interpretation of these, however, does not vest with the C&AG.

Question 28: Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession. Explain stating clearly the definition of Government auditing as discussed in U.N. Handbook on Govt Auditing and Developing Countries and also state Objectives of Govt audit. [MTP MAY 2022]

Answer 28: Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession.

The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows:

Government auditing is

- the objective, systematic, professional and independent examination
- of financial, administrative and other operations
- of a public entity

- made subsequently to their execution
- for the purpose of evaluating and verifying them,
- presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions
- by the responsible officials
- and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

OBJECTIVES:-

- a. Accounting for Public Funds:- Government audit serves as a mechanism or process for public accounting of government funds.
- b. Appraisal of Government policies:- It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
- c. Base for Corrective actions:- Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.

Question 29: What are the special steps involved in conducting the audit of an Educational Institution? (Write any 12 points). [MTP MAY 2022]

Answer 29: The Special Steps Involved in the Audit of an Educational Institution are the following:

- i. Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
- ii. Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure
- iii. Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of

- internal check which ensures that demands against the students are properly raised.
- iv. Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
 - v. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
 - vi. Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
 - vii. See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
 - viii. Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
 - ix. Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
 - x. Verify rental income from landed property with the rent rolls, etc.
 - xi. Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
 - xii. Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
 - xiii. Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.
 - xiv. Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

- xv. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- xvi. Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- xvii. Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- xviii. Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- xix. Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.
- xx. See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- xxi. Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- xxii. Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Inventory Register and values applied to various items should be test checked.
- xxiii. Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- xxiv. Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

Question 30: You have been appointed auditor of Dr. Prem Ratan Hospital. Discuss any eight important points that would attract your attention while audit. [MTP MAY 2022]

Answer 30: AUDIT OF HOSPITAL

The important points involved in such an audit are stated below-

- i. **Register of patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- ii. **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For eg. copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills etc.
- iii. **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.
- iv. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- v. **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- vi. **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.
- vii. **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.

Question 31: "Public moneys should not be utilised for the benefit of a particular person or section of the community". List out the exceptions to this rule while audit against propriety. [MTP MAY 2022]

Answer 31: Exceptions to the rule - Audit Against Propriety: Public moneys should not be utilised for the benefit of a particular person or section of the community unless:

- i. the amount of expenditure involved is insignificant; or
- ii. a claim for the amount could be enforced in a Court of law; or
- iii. the expenditure is in pursuance of a recognised policy or custom; and
- iv. the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

Question 32: The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 provides certain powers to the C & AG in connection with performance of his duties. Discuss. [MTP MAY 2022]

Answer 32: Powers of C & AG in performance of his duties: The Comptroller and Auditor General's (Duties, Powers and Condition of Service) Act, 1971 gives the following powers to the C&AG in connection with the performance of his duties:

- i. To inspect any an office accounts under the control of the union or a State Government including office responsible for creation of initial or subsidiary accounts.
- ii. To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
- iii. To put such questions or make such observations as he may
- iv. consider necessary to the person- in charge of the office and to call for such information as he may require for preparation of any account or report, which is his duty to prepare.

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transaction as he may determine.

Question 33: PQR Ltd., a government company, constructed a building in conformity with rules and regulations for installing a telephone exchange but not used for the same purpose resulting in the infructuous expenditure.

Considering the above case, explain the type of expenditure audit to be performed to curb the situation. [MTP NOV 2021]

Answer 33: Propriety audit: According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Further, it may so happen that a transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned but may still be highly wasteful.

In the given situation, PQR Ltd. being a government company, constructed a building in conformity with rules and regulations for installing a telephone exchange but not used for the same purpose resulting in an infructuous expenditure.

Thus, propriety audit should be done for PQR Ltd. to bring out improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations to the notice of the proper authorities of wastefulness in public administration.

Question 34: List out the types of Revenue Grants received by local bodies from the State. [MTP NOV 2021]

Answer 34: Revenue grants received by Local Bodies:

Local bodies may receive different types of grants from the state administration. Broadly the revenue grants are of three types:

1. **General purpose grants:** These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.
2. **Specific purpose grants:** These grants which are tied to the provision of certain services or performance of certain tasks.
3. **Statutory and compensatory grants:** These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

Question 35: The audit of government expenditure is one of the major components of government audit. Explain the basic standards set for such audit of expenditure. [MTP NOV 2021]

Answer 35: The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure

that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—

- i. that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the **audit against 'rules and orders'**.
- ii. that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the **audit of sanctions**.
- iii. that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as **audit against provision of funds**.
- iv. that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as **propriety audit**.
- v. that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the **performance audit**.

Question 36: GSR & Co. has been appointed as an auditor of Tagore School. Engagement team wants to verify Fees from students in detail. Advise the audit procedure to be followed by the engagement team. [MTP NOV 2021]

Answer 36: Fee from Students :-

1. Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
2. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

3. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
4. Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
5. See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee.
6. Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority
7. Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded

Question 37: The audit programme of NGO should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material item is omitted. Explain. [MTP NOV 2021]

Answer 37: The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material item is omitted.

- i. **Corpus Fund:** The contributions / grants received towards corpus be vouched with special reference to the letters from the donor(s). The interest income be checked with Investment Register and Physical Investments in hand.
- ii. **Reserves:** Vouch transfers from projects / programmes with donors letters and board resolutions of NGO. Also check transfer of gross value of asset sold from capital reserve to general reserve and adjustments during the year.
- iii. **Ear-marked Funds:** Check requirements of donors institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
- iv. **Project / Agency Balances:** Vouch disbursements and expenditure as per agreements with donors for each of the balances.
- v. **Loans:** Vouch loans with loan agreements, counterfoil of receipt issued.

- vi. **Fixed Assets:** Vouch all acquisitions / sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/ agreements for the grant. In the case of immovable property check title, etc.
- vii. **Investments:** Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis - investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
- viii. **Cash in Hand:** Physically verify the cash in hand and imprest balances, at the close of the year and whether it tallies with the books of account.

Question 38: Briefly explain the provisions for qualification and appointment of Auditors under the Multi-State Co-operative Societies Act, 2002. [MTP NOV 2021]

Answer 38: Qualification of Auditors - Section 72 of the Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of Multi-State co-operative society.

However, the following persons are not eligible for appointment as auditors of a Multi-State co-operative society-

- i. A body corporate.
- ii. An officer or employee of the Multi-State co-operative society.
- iii. A person who is a member or who is in the employment, of an officer or employee of the Multi-State co-operative society.
- iv. A person who is indebted to the Multi-State co-operative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State co-operative society for an amount exceeding one thousand rupees.

If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

Appointment of Auditors - Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration

of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State co-operative society in the general meeting may appoint the first auditor or auditors.

The subsequent auditor or auditors are appointed by Multi-State co-operative society, at each annual general meeting. The auditor or auditors so appointed shall hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

Question 39: Cinescreen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets?
[MTP NOV 2021]

Answer 39: Audit of Cinema: The special steps involved in its audit are stated below-

- i. Verify that entrance to the cinema-hall during show is only through printed tickets;
- ii. Verify that they are serially numbered and bound into books;
- iii. Verify that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
- iv. Verify that for advance booking a separate series of tickets is issued;
- v. Verify that the inventory of tickets is kept in the custody of a responsible official.
- vi. Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
- vii. Verify that a record is kept of the 'free passes' and that these are issued under proper authority..
- viii. Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class.

- ix. Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.

Question 40: The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. Explain. [MTP NOV 2020]

Answer 40: Compile and submit Accounts of Union and States - The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. The Comptroller and Auditor General shall, from the accounts compiled by him or [by the Government or any other person responsible in that behalf] prepare in each accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union Territory having a Legislative Assembly, and shall submit those accounts to the President or the Governor of a State or Administrator of the Union Territory having a Legislative Assembly, as the case may be, on or before such dates as he may, with the concurrence of the Government concerned, determine.

The C&AG Act of 1971 has provisions for relieving him of this responsibility to give information and render assistance to the Union and States: The Comptroller and Auditor General shall, in so far as the accounts, for the compilation or keeping of which he is responsible, enable him so to do, give to the Union Government, to the State Government or to the Governments of Union Territories having Legislative Assemblies, as the case may be, such information as they may, from time to time, require and render such assistance in the preparation of the annual financial statements as they may reasonably ask for.

Question 41: Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain. [RTP May 2024]

Answer 41: Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of

management to introduce controls which will minimize the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations.

The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.

The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

Question 42: From a lessee's perspective, highlight main differences between an operating lease and finance lease only in relation to accounting treatment and tax benefits. [RTP May 2024]

Answer 42: Accounting treatment: Operating lease is generally treated like a renting arrangement. Lease payments are treated as operating expenses and asset does not appear as asset in lessee's balance sheet. Finance lease is treated like a loan arrangement. Hence, asset ownership is considered of that of lessee and thus appears on the balance sheet of the lessee.

Tax benefits: Operating lease payment is considered like an expense just as in case of renting. However, no depreciation can be claimed by lessee. In case of finance lease, lessee can claim both interest and depreciation as it is treated like a loan.

Chapter-10: Audit of Banks

Question 1: Your firm of auditors, SRG & Co., has been appointed as Statutory Central Auditors of Reliable Bank. Explain the reporting requirements of the Statutory Central Auditors (SCAs) in addition to their main audit report.

[RTP -MAY 2021]

Answer 1: Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

- a) Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.
- b) Long Form Audit Report. (LFAR)
- c) Report on compliance with SLR requirements.
- d) Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.
- e) Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.
- f) Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.
- g) Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.
- h) Report on instances of adverse credit-deposit ratio in the rural areas.

Question 2: Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are

granted. The audit of advances requires the major attention from the auditors. Explain the broad considerations about which the auditor is primarily concerned with obtaining evidence in carrying out audit of advances. [RTP -MAY 2021]

Answer 2: Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

- a. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:
- b. Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- c. Advances represent amount due to the bank.
- d. Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
- e. There are no unrecorded advances.
- f. The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
- g. The advances are disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory and regulatory requirements.
- h. Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

Question 3: The engagement team discussion ordinarily includes a discussion of the matters such as - Errors that may be more likely to occur; Errors which have been identified in prior years;

Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures; etc.

In the above context, explain the advantages of such a discussion. [RTP -NOV 2021]

Answer 3: Advantages of such a discussion:-

- Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
- Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

Question 4: In carrying out an audit of interest expense, the auditor is primarily concerned with; assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense. [RTP -NOV 2021]

Answer 4: In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.

The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.

The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences. The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger. The auditor should understand the

process of computation of the average balance and re-compute the same on sample basis.

The auditor should, on a test check basis, verify the calculation of interest and ensure that:

- a) Interest has been provided on all deposits upto the date of the balance sheet;
- b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;
- c) Interest on savings accounts are in accordance with the rules framed by the bank/RBI in this behalf.
- d) Interest on inter-branch balances has been provided at the rates prescribed by the head office/RBI.

The auditor should ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period. The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly. The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers. The auditor should re-compute the interest accrual i.e., by referring to the parameters like frequency of payment of interest amount, rate of interest, period elapsed till the date of balance sheet, etc. from the term sheet, deal ticket, agreements, etc. and ensure that the recomputed amount is tallying with the amount as per books of accounts without any significant difference.

Question 5: There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets. Explain in detail. [RTP -MAY 2022]

Answer 5: Classification as NPA should be based on the record of recovery.

Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets which are given below:

<u>Categories of Non-Performing Assets:</u>	Provision required	
<u>Substandard Assets:</u> Would be one, which has remained NPA for a period less than or equal to 12 months.	15%	
<u>Doubtful Assets:</u> Would be one, which has remained in the substandard category for a period of 12 months.	Secured+ Unsecured	
<u>Sub-categories:</u>		
Doubtful up to 1 Year (D1)	25%	+ 100%
Doubtful 1 to 3 Years (D2)	40%	+ 100%
Doubtful more than 3 Years (D3)	100%	+ 100%
<u>Loss Assets:</u> Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%	

Question 6: Explain the following in the context of Bank audit:

- For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses.
- For audit of Provisions and contingencies, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. [RTP -MAY 2022]

Answer 6:

- For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures. The auditor should examine whether there are any divergent trends

in respect of major items of expenses. The auditor should perform substantive analytical procedures in respect of these expenses. e.g. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years. The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

- b. **For audit of Provisions and contingencies**, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.

The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation. The other provisions for expenses should be examined vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Question 7: CA. Puranjay is appointed as statutory branch auditor of two branches of a nationalized bank for year 2021-22. During the course of audit, he came across the following:

- a. While verifying advances of one semi-urban branch, he noticed substantial number of accounts categorized as SMA (Special mention accounts). In this context, explain the nature and significance of SMA.
- b. While verifying interest income of a mid-corporate branch of an urban centre having advances consisting of only cash credit limits for large borrowers, it was noticed that advances of Rs.300 crores were outstanding as on balance sheet date carrying average interest rate @8% p.a.

One articulated clerk in audit team makes quick back of the envelope calculations of interest income of Rs.24 crores on advances. However, schedule of profit & loss a/c shows interest income on advances for Rs.10 crores. Discuss any two probable reasons for such variation. [RTP -NOV 2022]

Answer 7:

- a. Special Mention accounts (SMA) are those accounts which are resulting signs of incipient stress leading to the possibility that borrowers may default on debt obligations. These are in the nature of warning system to alert the banks about probable NPAs so that remedial action can be taken before accounts actually turn NPAs. Therefore, their significance lies in the fact that proper and timely identification of SMAs can help in preventing turning potential NPAs into actual NPAs.
- b. The probable reasons for difference in interest calculation could be due to following:
 - i. Cash credit accounts, by their very nature, are running accounts and their utilization depends upon needs of business. Further, interest on cash credit account is charged on the extent of funds utilized by the borrower. It could be possible that all cash credit limits were not fully utilized during the year which resulted in lower interest income.
 - ii. Some large accounts may have been sanctioned during later part of the year resulting in lower interest income on advances for whole year.

Question 8: In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about amounts included in balance sheet in respect of advances which are outstanding. Explain stating clearly all the considerations in this context. [RTP -NOV 2022]

Answer 8: Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

- a. Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- b. Advances represent amount due to the bank.
- c. Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
- d. There are no unrecorded advances.
- e. The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
- f. The advances are disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory and regulatory requirements.
- g. Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

Question 9: Compute the Drawing Power for Cash Credit A/c of S Limited for the month of March 2022 with following information:

Stock	50,000
Debtors	45,000
(Including Debtor of Rs.5,000 for an invoice dated 17.11.2021)	
Sundry creditors	15,000
Sanctioned Limit	45,000
Margin on stock is 20% and on debtors is 50%.	

Note: Debtors older than 3 months are ineligible for calculation of DP. [MAY 2022]

Answer 9: Computation of Drawing Power:

Computation of Drawing Power for CC A/c of S Ltd.

Particulars of current assets		Amount (Rs.)	DP Amt (Rs.)
(A) Stocks:			
Stocks at realizable value		50,000	
Less: Unpaid stocks:			
- Sundry creditors	15000	<u>15000</u>	
Paid for stocks		35000	
Margin @ 20%		<u>7000</u>	28000
(B) Debtors:			
Total Debtors		45000	
Less: Ineligible debtors		<u>5000</u>	
Eligible debtors		40000	
Margin @ 50%		<u>20000</u>	20000
Total Drawing Power			48000

The sanctioned limit given in the question is Rs.45000 whereas drawing power as per the above working is Rs.48000. So, drawing power would be restricted to sanctioned limit i.e. Rs. 45000.

Question 10: After becoming Chartered Accountant, you have got your first assignment as an auditor of a bank branch dealing in various types of advances. What are the areas which you will be looking for obtaining sufficient appropriate evidence (for advances) besides studying and evaluating internal controls? [MAY 2022]

Answer 10: Audit Procedure in Audit of Advances in case of Bank Audit: The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by:

- i. examining the validity of the recorded amounts;

- ii. examining loan documentation.
- iii. reviewing the operation of the accounts;
- iv. examining the existence, enforceability and valuation of the security;
- v. checking compliance with RBI norms including appropriate classification and provisioning; and
- vi. carrying out appropriate analytical procedures.

Question 11: In a bank, all accounts should be kept within the drawing power and the sanctioned limit. The accounts which exceed the sanctioned limit or drawing power should be brought to the notice of the management regularly. Analyse the following points to be considered in the computation of drawing power in case of bank audit.

- i. Bank's Duties
- ii. Auditor's concern
- iii. Computation of DP
- iv. Stock audit [MAY 2022]

Answer 11: Computation of Drawing Power:

- a. **Bank's Duties:** Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets. Drawing power is required to be arrived at based on current stock statement. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular.
- b. **Auditor's Concern:** The stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail. The audited Annual Report submitted by the borrower should be scrutinized properly. The monthly stock statement of the month for which the audited accounts are prepared and submitted should be compared and the reasons for deviations, if any, should be ascertained.

- c. **Computation of DP:** It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.
- d. **Stock Audit:** The stock audit should be carried out by the bank for all accounts having funded exposure of more than I 5 crores. Auditors can also advise for stock audit in other cases if the situation warrants the same. Branches should obtain the stock audit reports from lead bank in the cases where the Bank is not leader of the consortium of working capital. The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.

Question 12: N Ltd. has been sanctioned a Cash Credit Facility by XYZ Bank Ltd. for INR 1 crore and drawing power as per the stock statements furnished for the last quarter is INR 80 Lakh. Outstanding balance in the account is INR 75 lakh. Interest charged to the account is INR 3.5 Lakh and total credit into the account for the quarter is INR 2.5 Lakh. As an auditor how will you report this account in your report. [JULY 2021]

Answer 12: Out of Order: An account should be treated as 'out of order' if:

- the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet; or
- Credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Applying the above to the given case of N Ltd, its Drawing power is Rs.80 Lakhs, although outstanding balance in the account is Rs.75 Lakhs, but still the account would be reported as out of order because credits in the account are not sufficient to cover the interest debited during the same period

Question 13: Discuss the advantages of engagement team discussion done at the planning stage of the bank audit. [JULY 2021]

Answer 13: Advantages of engagement team discussion done at the planning stage of Bank audit are:

- Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
- Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

Question 14: Explain "Advances under Consortium" in the context of Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances. [JAN 2021]

Answer 14: Advances under Consortium: Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

Question 15: You are appointed as Statutory Auditor of DEF Bank Limited for the year 2019-20. As an Auditor how will you verify Provisions created by DEF Bank Limited? [JAN 2020]

Answer 15: For audit of Provisions, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.

The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation. The other provisions for expenses should be examined vis-à-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Question 16: Explain the audit approach you would follow to check the Operating Expenses of a Bank. [RTP NOV 2022]

Answer 16: Auditing the Operating Expenses of a Bank:

- i. **Internal Controls:** The auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures.
- ii. **Divergent Trends:** The auditor should examine whether there are any divergent trends in respect of major items of expenses.
- iii. **Substantive analytical Procedures:** The auditor should perform substantive analytical procedures in respect of these expenses. eg. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.
- iv. **Vouching & Verification:** The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

Question 17: What are the general requirements of an effective Risk Management System in Banks? [RTP NOV 2022]

Answer 17: Understanding the Risk Management Process: Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

- i. **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (Board of Directors/Managing Director) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.
- ii. **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.
- iii. **Control activities:** A bank should have appropriate controls to mitigate its risks including effective segregation of duties (particularly between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.
- iv. **Monitoring activities:** Risk management models, methodologies and assumptions used to measure and mitigate risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.
- v. **Reliable information systems:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

Question 18: When is an agricultural advance considered as non performing as per the RBI guidelines? [MTP NOV 2022]

Answer 18: As per the guidelines, Agricultural Advances are of two types:

1. Agricultural Advances for "long duration" crops; and
2. Agricultural Advances for "short duration" crops.

The "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State.

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons; and
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

Question 19: Explain hypothecation and assignment as the modes of creation of security with respect to advance granted by a bank. [MTP NOV 2022]

Answer 19: Hypothecation:

The hypothecation is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower.

Neither ownership nor possession is transferred to the bank. However, the borrower holds the physical possession of the goods as an agent/trustee of the bank. The borrower periodically submits statements regarding quantity and value of hypothecated assets (stocks, debtors, etc.) to the lending banker on the basis of which the drawing power of the borrower is fixed.

Assignment:

Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favor of another person. Only actionable claims (i.e., claim to any debt other than a debt secured by a mortgage of immovable property or by hypothecation or pledge of moveable property) such as book debts and life insurance

policies are accepted by banks as security by way of assignment. An assignment gives the assignee absolute right over the moneys/debts assigned to him.

Question 20: In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount. Explain the Audit Approach and Procedures regarding following points in the above context :

- i. RBI's Directions
- ii. Materiality
- iii. Revenue Certainty
- iv. Revenue Uncertainty [MTP NOV 2022]

Answer 20: Audit Approach and Procedures

- **Auditor's Concern:** In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount.
- **RBI's Directions:** RBI has advised that in respect of any income which exceeds one percent of the total income of the bank if the income is reckoned on a gross basis or one percent of the net profit before taxes if the income is reckoned net of costs, should be considered on accrual as per Accounting Standard 9.
- **Materiality:** If any item of income is not considered to be material as per the above norms, it may be recognised when received and the auditors need not qualify their report in that situation.
- **Revenue Certainty:** Banks recognise income (such as interest, fees and commission) on accrual basis, i.e., as it is earned. It is an essential condition for accrual of income that it should not be unreasonable to expect its ultimate collection. In modern day banking, the entries for interest income on advances are automatically generated through a batch process in the CBS system.

- **Revenue Uncertainty:** In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also.

Question 21: In case of a Bank, explain the meaning of Funded loans. Also give examples. [MTP NOV 2021]

Answer 21: Funded loans are those loans where there is an actual transfer of funds from the bank to the borrower.

Advances comprise of funded amounts by way of:

- Term loans
- Cash credits, Overdrafts, Demand Loans
- Bills Discounted and Purchased
- Participation on Risk Sharing basis
- Interest-bearing Staff Loans

Question 22: "There is no difference in provisioning of NPA as regards to categories of NPA, whether the debt is secured or unsecured." Critically evaluate the statement on the basis of provisioning norms of NPA of nationalised bank stating clearly the provision percent required. [MTP NOV 2021]

Answer 22: Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise.

Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub- standards assets, Doubtful assets and loss assets which are given below:

Categories of Non-Performing Assets:	Provision required
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◆ Substandard Assets: Would be one, which has remained NPA for a period less than or equal to 12 months.	15%	
◆ Doubtful Assets: Would be one, which has remained in the substandard category for a period of 12 months.	Secured+ Unsecured	
◆ Sub-categories:		
• Doubtful up to 1 Year (D1)	25%	+ 100%
• Doubtful 1 to 3 Years (D2)	40%	+ 100%
• Doubtful more than 3 Years (D3)	100%	+ 100%
◆ Loss Assets: Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%	

Question 23: There are different types of banks prevailing in India. Explain giving examples of such banks. [MTP NOV 2021]

Answer 23: There are different types of banking institutions prevailing in India which are as follows:

Commercial Banks	Regional Rural Banks
Co-operative Banks.	Payment Banks.
Development Banks (more commonly known as 'Term-Lending Institutions').	Small Finance Banks.

1. **Commercial banks** are the most wide spread banking institutions in India, that provide a number of products and services to general public and other segments of economy. Two of its main functions are:-

- a) accepting deposits and
- b) granting advances.

2. **Regional Rural Banks** known as **RRBs** are the banks that have been set up in rural areas in different states of the country to cater to the basic banking and financial needs of the rural communities. **Examples are** :- Punjab Gramin Bank , Tripura Gramin Bank , Allahabad UP Gramin Bank , Andhra Pradesh Grameen Vikas Bank, etc.
3. **Co-operative Banks** function like Commercial Banks only but are set up on the basis of Cooperative Principles and registered under the Cooperative Societies Act of the respective state or the Multistate Cooperative Societies Act and usually cater to the needs of the agricultural and rural sectors. **Examples are** :- The Gujarat State Co-operative Bank Ltd. , Chhatisgarh Rajya Sahakari Bank Maryadit , etc.
4. **Payments Banks** are a new type of banks which have been recently introduced by RBI. They are allowed to accept restricted deposits but they cannot issue loans and credit cards. However, customers can open Current & Savings accounts and also avail the facility of ATM cum Debit cards , Internet-banking & Mobile banking. **Examples are** :- Airtel Payments Bank , India Post Payments Bank, Paytm Payments Bank , etc.
5. **Development Banks** had been conceptualized to provide funds for infrastructural facilities important for the economic growth of the country. **Examples are**:- Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI) , etc.
6. **Small Finance Banks** have been set up by RBI to make available basic financial and banking facilities to the unserved and **unorganised** sectors like small marginal farmers, small & micro business units, etc. **Examples are**:- Equitas Small Finance Bank , AU Small Finance Bank , etc.

Question 24: In case of a Bank, explain the meaning of Funded loans. Also give examples. [MTP NOV 2021]

Answer 24: **Funded** loans are those loans where there is an actual transfer of funds from the bank to the borrower.

Advances comprise of funded amounts by way of:

- Term loans :-

- Cash credits, Overdrafts, Demand Loans
- Bills Discounted and Purchased
- Participation on Risk Sharing basis
- Interest-bearing Staff Loans

Question 25: Newton Ltd. has made loans and advances on the basis of following securities to various borrowers. As an auditor what type of documents can be verified to ensure that the company holds a legally enforceable security?

- i. Shares and Debentures
- ii. Life Insurance Policy
- iii. Hypothecation of goods. [MTP NOV 2021]

Answer 25: Documents to be seen in case of Securities:

Types of Security	Documents etc. to be seen
(i) Shares and debentures	The scrip and the endorsement thereon of the name of the transferee, in the case of transfer.
(ii) Life Insurance Policy.	Assignment of policy in favour of the lender, duly registered with the insurer
(iii) Hypothecation of goods	Deed of hypothecation or other document creating the charge, together with a statement of inventories held at the Balance Sheet date

Question 26: Banks ask Security or Collateral while lending to assure that the Borrower will return the money to bank in prescribed time. Explain stating clearly the concept of Primary and Collateral Security. Also give examples of most common types of securities accepted by banks. [MTP NOV 2020]

Answer 26: Banks ask Security or Collateral while lending to assure that the Borrower will return the money to bank in prescribed time else the Banks have legal authority to sell the collateral to recover its money.

Nature of Security

- A. **Primary security** refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.
- B. **Collateral security** is an additional security. Security can be in any form i.e. tangible or intangible asset, movable or immovable asset.

Examples of most common types of securities accepted by banks are the following:

- Personal Security of Guarantor
- Goods/Stocks/Debtors/Trade Receivables
- Gold Ornaments and Bullion
- Immovable Property
- Plantations (For Agricultural Advances)
- Third Party Guarantees
- Banker's General Lien
- Life Insurance Policies
- Stock Exchange Securities and Other Instruments



Chapter-11: Ethics and Terms of Audit Engagements

Question 1: The fundamental principles of ethics establish the standard of behaviour expected of a professional accountant. A professional accountant shall comply with each of the fundamental principles. What are the fundamental principles of professional ethics?

Answer 1: A professional accountant shall comply with each of the fundamental principles. The fundamental principles of professional ethics are as follows:

1. **Integrity:** A professional accountant shall comply with the principle of integrity, which 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.

2. **Objectivity:** The principle of objectivity requires an auditor not to compromise professional judgment because of bias, conflict of interest or undue influence of others. It requires that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.
3. **Professional competence and due care:** A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and act diligently and in accordance with applicable technical and professional standards. Diligence includes responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.
4. **Confidentiality :** Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships. Confidentiality serves the public

interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant with the understanding that the information will not be disclosed to a third party. However, such confidential information may be disclosed, for example, when it is required by law, when it is permitted by law and is authorised by the client or employer or there is a professional duty or right to disclose when not prohibited by law.

- 5. Professional Behaviour :** It requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

Question 2: What is Self-interest threats ? Explain giving examples.

Answer 2: Self-interest threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include

- (i) direct financial interest or materially significant indirect financial interest in a client
- (ii) loan or guarantee to or from the concerned client
- (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement
- (iv) close business relationship with an audit client
- (v) potential employment with the client and
- (vi) contingent fees for the audit engagement

Question 3: What is Familiarity threats? Explain giving examples.

Answer 3: Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways including:

- i. close relative of the audit team working in a senior position in the client

company

- ii. former partner of the audit firm being a director or senior employee of the client
- iii. long association between specific auditors and their specific client counterparts and
- iv. acceptance of significant gifts or hospitality from the client company, its directors or employees.

Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to comply with the fundamental principles to an acceptable level. **To address the issue, which the guiding principles are to be applied?**

To address the issue, the following guiding principles are to be applied:-

- For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.
- Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
- When such threats exist, the auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level. All such safeguards measures need to be recorded in a form that can serve as evidence of compliance with due process.
- If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

Question 4: What is PROFESSIONAL SKEPTICISM? Professional skepticism includes being alert to?

Answer 4: Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence Professional skepticism includes being alert to, for example:

- ✓ Audit evidence that contradicts other audit evidence obtained.

- ✓ Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- ✓ Conditions that may indicate possible fraud.
- ✓ Circumstances that suggest the need for audit procedures in addition to those required by the SAs

Question 5: What is PROFESSIONAL SKEPTICISM? Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of what?

Answer 5: Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence

Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:

- Overlooking unusual circumstances.
- Over generalising when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Question 6: What are the Preconditions for an audit? In order to establish whether the preconditions for an audit are present, the auditor shall do what?

Answer 6: Preconditions for an audit may be defined as the

- use by management of an acceptable FRF in preparation of F.S. and
- agreement of management and, where appropriate, TCWG to the premise on which an audit is conducted.

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

- a. Determine whether the financial reporting framework is acceptable and
- b. Obtain the agreement of management that it acknowledges and understands its responsibility:
 - i. For the preparation of the financial statements in accordance with the applicable financial reporting framework including where relevant

- their fair representation;
- ii. For such internal control as management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - iii. To provide the auditor with:
 - Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Question 7: The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. Such a letter includes what?

Answer 7: The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent.

Such a letter includes:-

- a. The objective and scope of the audit of the financial statements
- b. The responsibilities of the auditor
- c. The responsibilities of management
- d. Identification of the applicable financial reporting framework for the preparation of the financial statements and
- e. Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Question 8: The auditor may decide not to send a new audit engagement letter

or other written agreement each period. However, which are the factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms?

Answer 8: The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- i. Any indication that the entity misunderstands the objective and scope of the audit.
- ii. Any revised or special terms of the audit engagement.
- iii. A recent change of senior management.
- iv. A significant change in ownership.
- v. A significant change in nature or size of the entity's business.
- vi. A change in legal or regulatory requirements.
- vii. A change in the financial reporting framework adopted in the preparation of the financial statements.
- viii. A change in other reporting requirements.

Question 9: A firm before accepting an engagement should acquire vital information about the client. With regard to the integrity of a client, matters that the firm considers include, explain giving examples?

Answer 9: A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:-

- Integrity of Client
- Competence (including capabilities, time and resources) to perform engagement
- Compliance with ethical requirements

With regard to the integrity of a client, matters that the firm considers include, for example:

1. The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.

2. The nature of the client's operations, including its business practices.
3. Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
4. Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
5. Indications of an inappropriate limitation in the scope of work.
6. Indications that the client might be involved in money laundering or other criminal activities.
7. The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

Question 10: As per SA 220, the engagement partner should document what matters pertaining to an audit engagement?

Answer 10: The engagement partner should document following matters pertaining to an audit engagement: -

1. Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
2. Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
3. Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.

The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

Question 11: On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The auditor may decide not to send a new audit engagement letter or other written agreement each period. Explain the factors an auditor considers to be appropriate to revise the terms of the audit engagement or to remind the entity of existing terms. [RTP -MAY 2021]

Answer 11: On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

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

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in ownership.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

Question 12: The Chartered Accountant has a responsibility to remain independent by considering the context in which they practice, the threats to independence and the safeguards available to eliminate the threats. Explain the guiding principles in this regard.

Answer 12: The Chartered Accountant has a responsibility to remain independent by considering the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard: -

- i. For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.
- ii. In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.
- iii. Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.

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

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

Question 13: An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain the circumstances which may contribute towards a request from the client for the auditor to change the engagement.

Answer 13: An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from-

1. a change in circumstances affecting the need for the service,
2. a misunderstanding as to the nature of an audit or related service originally requested.
3. a restriction on the scope of the engagement, whether imposed by management or caused by circumstances

Question 14: The engagement partner shall take the responsibility for the overall 'quality on each audit engagement to which that partner is assigned. Discuss with reference to SA 220 "Quality Control for an audit of financial statements". [NOV 2019]

Answer 14: As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

- a. The importance to audit quality of:
 - i. Performing work that complies with professional standards and regulatory and legal requirements;

- ii. Complying with the firm's quality control policies and procedures as applicable;
 - iii. Issuing auditor's reports that are appropriate in the circumstances; and
 - iv. The engagement team's ability to raise concerns without fear of reprisals; and
- b. The fact that quality is essential in performing audit engagements.

Question 15: There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. Explain.

Answer 15: There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:

Independence is:

1. **Independence of mind** - the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
2. **Independence in appearance** - the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised."