

CA-Inter

Auditing & Ethics

New Course

Booster No-56

(Theoretical & Case studies)

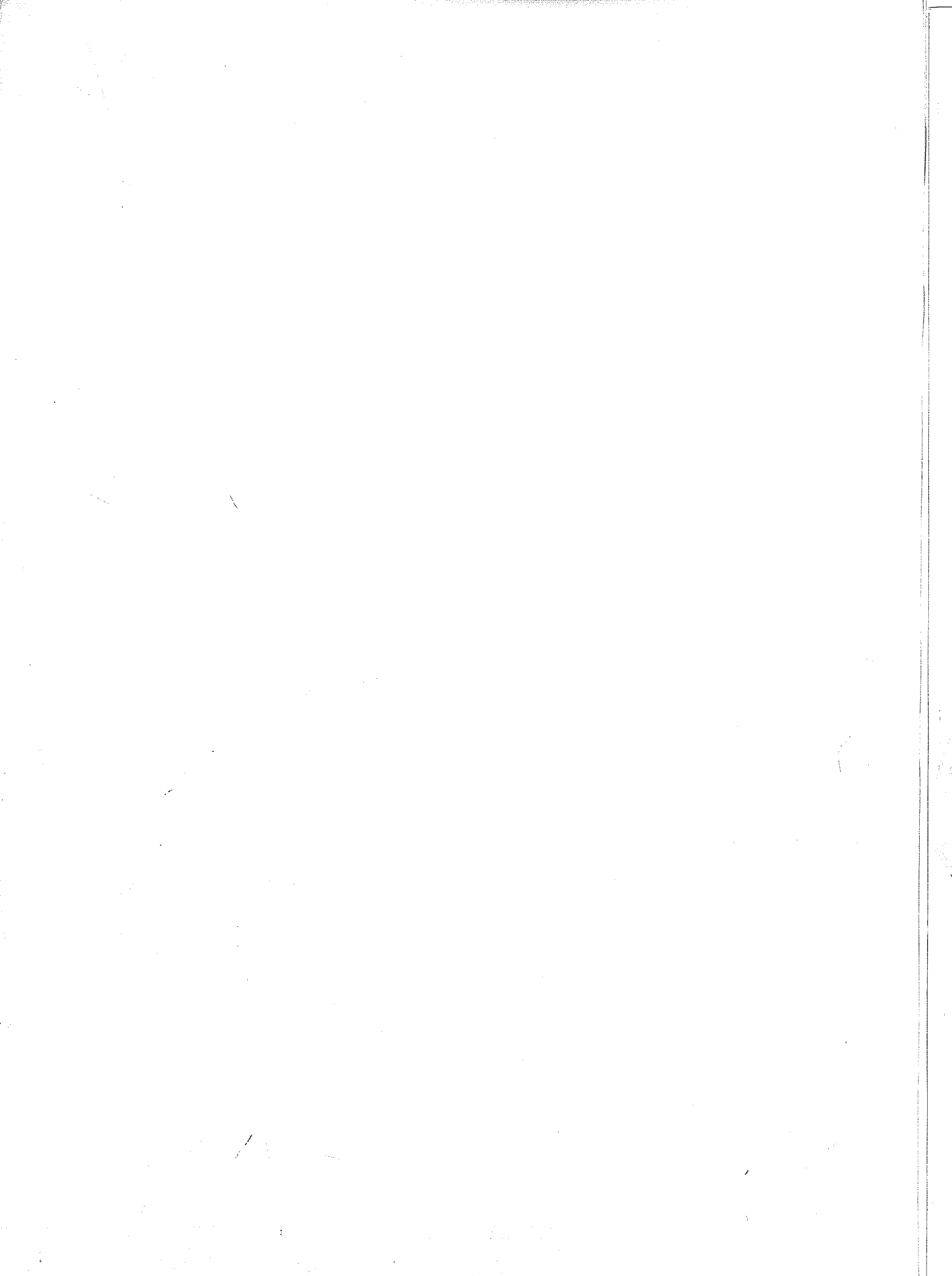


Containing Case Studies with answers of

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CA Ankit Oberoi

FCA, MBA (Fin.), PGDCLM

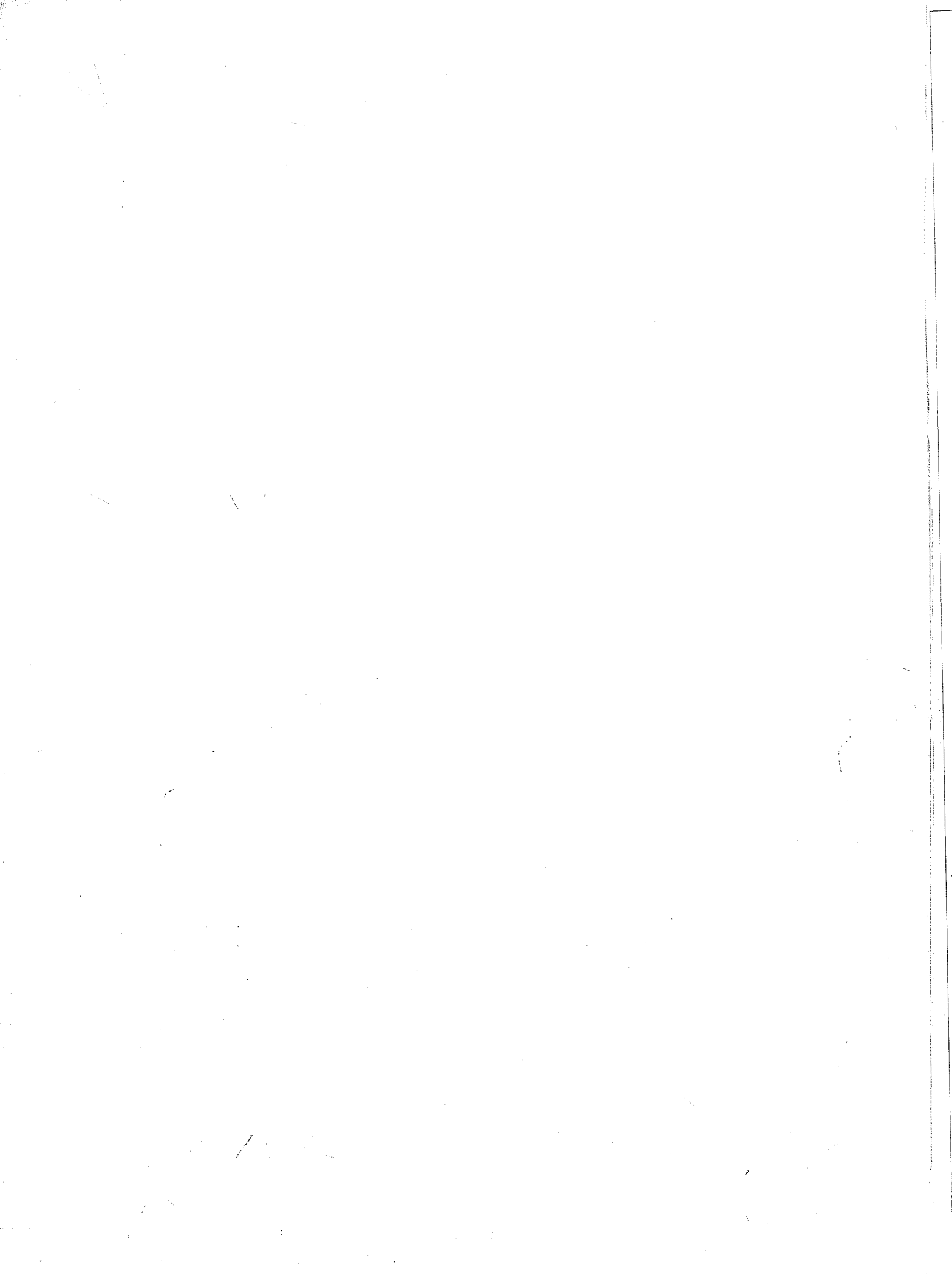


AUDITING & ETHICS

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(Theoretical & Case studies)

CA - INTERMEDIATE

CA ANKIT OBEROI
FCA, MBA (Fin.), PGDCLM

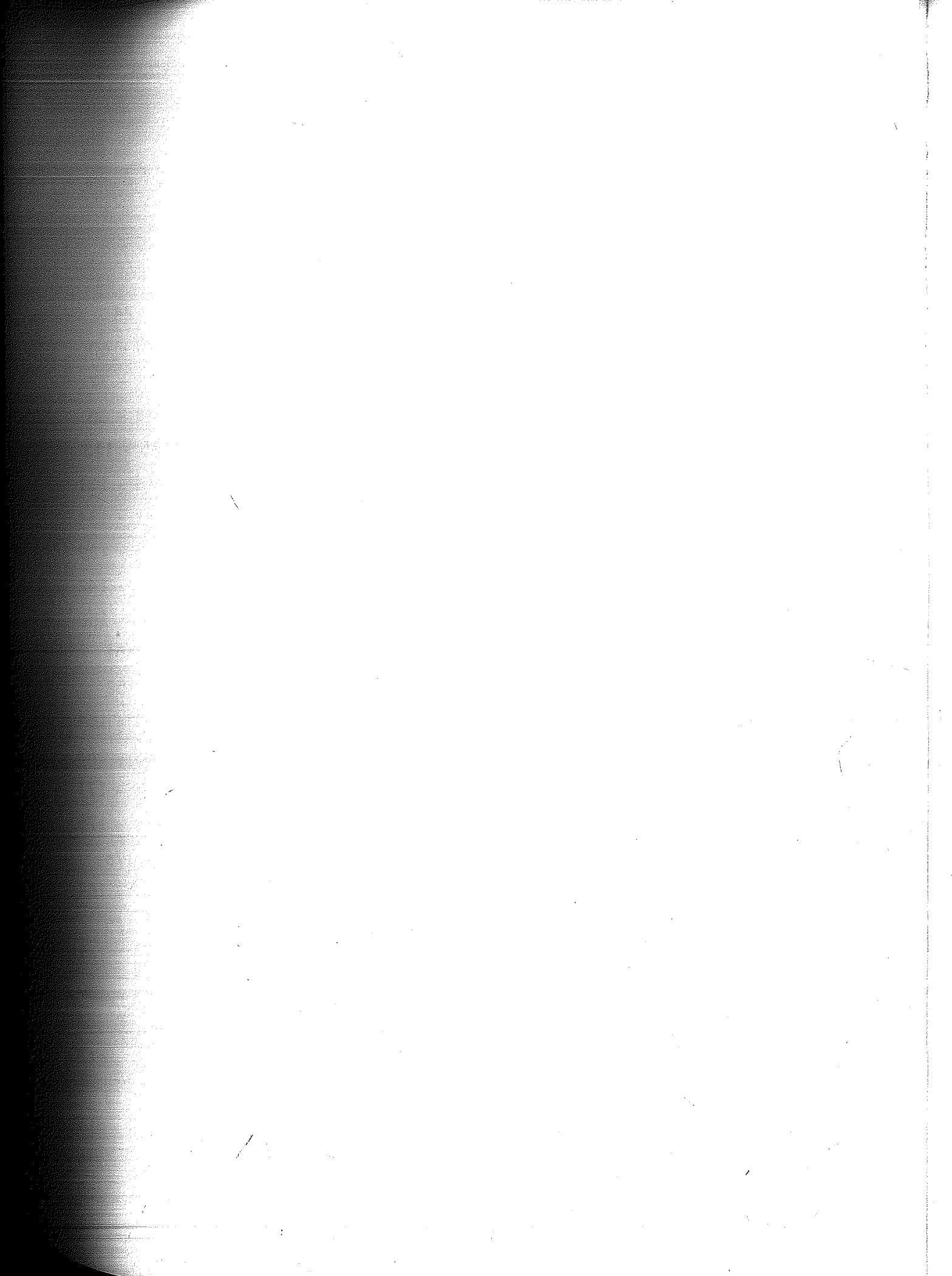


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Auditing & Ethics

Booster No-56

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Chapter - 1

Nature, Objective and Scope of Audit

STUDY MATERIAL NEW

Ques-1 "Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies.

Ans. Choosing of appropriate accounting policies is responsibility of management. The role of auditor lies in evaluating selection and consistent application of accounting policies by management- Refer to scope of audit- what it includes.

STUDY MATERIAL NEW

Ques-2 Assurance engagements are not restricted to audit of financial statements alone. Discuss.

Ans. There are various types of assurance Engagements:-

Reasonable assurance engagement: - It provides high level of assurance. It draws reasonable conclusions on the basis of sufficient appropriate evidence. Example of Reasonable assurance engagement is audit engagement.

Limited assurance engagement: -provides lower level of assurance than reasonable assurance engagement. It performs fewer procedures as compared to reasonable assurance engagement Example of limited assurance engagement is review engagement.

Moderate assurance engagement: - Besides reasonable assurance engagements and limited assurance engagements, there is another kind of assurance which is related to matters other than historical financial information. Such an assurance may relate to prospective financial information and not to historical financial information. It may relate to providing assurance on internal controls in an entity.

"Prospective financial information" means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.

STUDY MATERIAL NEW

Ques-3 An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement.

Ans. A three party relationship involving a practitioner, a responsible party, and intended users

An assurance engagement involves abovesaid three parties.

A practitioner is a person who provides the assurance. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

A responsible party is the party responsible for preparation of subject matter.

Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

STUDY MATERIAL NEW

Ques-4 A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement.

Ans. It is not a reasonable assurance engagement. It is in nature of investigation.

STUDY MATERIAL NEW

Ques-5 An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance.

Ans. 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. For example,

an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability 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.

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.

STUDY MATERIAL OLD

Ques-6 Explain clearly meaning of Auditing. How would you as an auditor perform the audit.

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

STUDY MATERIAL OLD

Ques-7 "The independent audit of an entity's financial statements is a vital service to investors, trade payables, and other participants in economic exchange". Explain

- ✚ 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.

RTP MAY 20, MTP OCTOBER 21

Ques-8 The person conducting audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing.

Ans. As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
- (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

STUDY MATERIAL, RTP MAY 20, MTP OCT 20, RTP NOV 21,

Ques-9. There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples.

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. For example, an auditor does not test all transactions and balances. **He forms his opinion only by testing samples.** It is an example of practical limitation on auditor's ability to obtain audit evidence.

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RTP NOV 20

Ques-10. Both accounting and auditing are closely related with each other. Explain

Ans. Both accounting and auditing are closely related with each other as auditing reviews the financial statements which are nothing but a result of the overall accounting process. It naturally calls on the part of the auditor to have a thorough and sound knowledge of generally accepted principles of accounting before he can review the financial statements. In fact, auditing as a discipline is also closely related with various other disciplines as there is lot of linkages in the work which is done by an auditor in his day-to-day activities. To begin with, it may be noted that the discipline of auditing itself is a logical construct and everything done in auditing must be bound by the rules of logic. Ethical precepts are the basis on which the foundation of the entire accounting profession rests. The knowledge of language is also considered essential in the field of auditing as the auditor shall be required to communicate, both in writing as well as orally, in day-to-day work.

RTP NOV 21

Ques-11. The knowledge of human behavior is indeed very essential for an auditor so as to effectively discharge his duties. Explain.

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

The discipline of behavioral science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures.

One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are

competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

MTP APRIL 2022

Ques-12. The auditor has to form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Explain the above statement with reference to "Timeliness of Financial Reporting and the Balance between Benefit and Cost".

Ans. 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. Consider, for example, an auditor who is conducting audit of a company since last two years. During these two years, he has sought detailed information from management of company regarding various matters. During his third-year stint, he chooses to rely upon some information obtained as part of audit procedures of second year. However, it could be possible that something new has happened and that information is not relevant. So, the information being relied upon by auditor is not timely and may have lost its reliability

RTP MAY 2023

Ques-13. An audit is distinct from investigation. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. Discuss.

Ans.

INVESTIGATION	AUDIT
Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.	The objective of audit is 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.
scope of investigation is specific and narrow.	The scope of audit is general and broad

RTP NOV 2023

Ques-14 For auditor's opinion, reasonable assurance is an absolute level of assurance.

Ans. Reasonable assurance is a high level but not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Chapter - 2

Audit Strategy & Programme

STUDY MATERIAL NEW

Ques-1 "Purported disadvantages of an audit programme can be overcome". Do you agree?

Ans. Purported disadvantages of audit programme may be eliminated by imaginative supervision of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants; the assistants should be encouraged to observe matters objectively and bring significant matters to the notice of supervisor/principal.

RTP MAY 19, RTP NOV 20

Ques-2 Evolving one audit programme applicable to all business under all circumstances is not practicable. Explain

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

STUDY MATERIAL, RTP MAY 19

Ques-3 (a) The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed. Explain

(b) Explain the significant points auditor would consider while developing an audit programme.

Ans. (a) **Periodic Review of The Audit Programme**

There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

Example- if the audit programme for the audit of a branch of a financing house, drawn up a number of years ago, fails to take into consideration that the previous policy of financing of a vehicle has been changed to financing of real estate acquisition, the whole audit conducted thereunder would be entirely misdirected and may even result into nothing more than a farce. [Pacific Acceptance Corporation Ltd. v. Forsyth and Others.]

The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed. However, as a basic feature, audit programme not only lists the tasks to be carried out but also contains a few relevant instructions, like the extent of checking, the sampling plan, etc. So long as the programme is not officially changed by the principal, every assistant deputed on the job should unfailingly carry out the detailed work according to the instructions governing the work. Many persons believe that this brings an element of rigidity in the audit programme. This is not true provided the periodic review is undertaken to keep the programme as up-to-date as possible and by encouraging the assistants on the job to observe all salient features of the various accounting functions of the client.

(b) **Developing the Audit Programme :**

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

- 2. Audit objective and instruction to assistants:** The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of the work.
- 3. Reliance on Internal Controls:** In preparing the audit programme, the auditor, having an understanding of the accounting system and related internal controls, may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. The auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.
- 4. Timings of performance of audit procedures:** The auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.
- 5. Audit planning:** The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures

EXAM MAY 19, EXAM NOV 19

Ques-4 List out the points that should be kept in mind by the auditor for the purpose of constructing an audit programme

Ans. For the purpose of programme construction, the following points should be kept in mind:

- i. Stay within the scope and limitation of the assignment.
- ii. Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- iii. Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
- iv. Consider all possibilities of error.
- v. Co-ordinate the procedures to be applied to related items.

RTP NOV 20

Ques-5 In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. An auditor picks up evidence from a variety of fields. Analyse and explain with the help of examples.

Ans. In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. In this process, an auditor would be in a position to identify the evidence that brings the highest satisfaction to him about the appropriateness or otherwise of the assertion.

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

- (a) Documentary examination,
- (b) Physical examination,
- (c) Statements and explanation of management, officials and employees,
- (d) Statements and explanations of third parties,
- (e) Arithmetical calculations by the auditor,
- (f) State of internal controls and internal checks,
- (g) Inter-relationship of the various accounting data,
- (h) Subsidiary and memorandum records,
- (i) Minutes,
- (j) Subsequent action by the client and by others.

Example

1. For cash in hand, the best evidence is 'count'
2. For investment pledged with a bank, the banker's certificate.
3. For verifying assertions about book debts, the client's ledger invoices, debit notes, credit notes, monthly accounts statement sent to the customers are all evidence: some of these are corroborative, other being complementary. In addition, balance confirmation procedure is often resorted to, to obtain greater satisfaction about the reliability of the assertion.

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

EXAM DEC 21

Ques-6 M / s. TP & Co., a firm of Chartered Accountants, is auditor of KSR Ltd. For many years. KSR Ltd. Has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit program of earlier years to the audit assistants and instructed them to follow the same; the assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified or they are required to keep an open mind? Guide them.

Ans. The Assistant Engaged - Be Encouraged to Keep an Open Mind:

To start with, an auditor having regard to the nature, size and composition of the business and the dependability of the internal control and the given scope of work, should frame a programme which should aim at providing for a minimum essential work which may be termed as a standard programme. As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are found relevant for the particular concern. Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped. The assistant engaged in the job should be encouraged to keep an open mind beyond the programme given to him. He should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit. In the given case, the attitude of assistants of TP & Co. is not justified. They should keep an open mind and go beyond the programme to take care of newer areas of the business of KSR Ltd. into which the Company has diversified.

MTP MARCH 2022

Ques-7 CA Vikas Jain discussed with his audit team about advantages and disadvantages of audit programme. He explained to his team that -"work may become mechanical" as disadvantage of the audit programme. Discuss explaining the disadvantages of an audit programme

Ans. Some disadvantages are there in the use of audit programme. The disadvantages are:

- (i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
- (ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
- (iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- (iv) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

MTP OCT 2022

Ques-8 XYZ & associates are appointed as the statutory auditors of Fisco Ltd. For the F.Y 2021-22. While constructing the audit programme, the engagement partner, CA X should keep in mind various points. List such points.

Ans: 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.

Chapter - 3

Risk Assessment and Internal Control

STUDY MATERIAL NEW

Ques-1 Discuss relationship between "General IT controls" and "application controls" in an automated environment.
Ans. General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls.

It maintain the integrity of information and security of data commonly include controls over the following:

- Data center and network operations
- Program change
- Access security
- Application system acquisition, development, and maintenance

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

Application controls include both automated or manual controls that operate at a business process level. Automated Application controls are embedded into IT applications viz., ERPs and help in ensuring the completeness, accuracy and integrity of data in those systems.

STUDY MATERIAL NEW

Ques-2 A company functions in an automated environment. Discuss in what areas data analytics can be useful for auditor of the company.

Ans. In today's digital age when companies rely on more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. 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

STUDY MATERIAL NEW / EXAM NOV 20

Ques-3 The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting" Explain.

OR

Discuss " Monitoring of control" as a component of Internal control

Ans. The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.

(i) Monitoring of controls Defined: Monitoring of controls is a process to assess the effective ness of internal control performance over time.

(ii) Helps in assessing the effectiveness of controls on a timely basis: It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.

(iii) Management accomplishes through on-going activities, separate evaluations etc.: Management accomplishes monitoring of controls through on-going activities, separate evaluations, or a combination of the

two. On-going monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

(iv) **Management's monitoring activities include:** Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

(v) **In case of Small Entities:** Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.

STUDY MATERIAL NEW

Ques-4 "Risk of material misstatement consists of two components" Explain clearly defining risk of material misstatement.

OR

Define Risk of material misstatement. Explain its components also.

Ans. Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statement are materially misstated. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment.

Audit Risk could be simply understood as follows:

During the audit of a company if the financial statements of that company are misstated and those misstatements are material in nature, then there will be a risk that audit opinion given by the auditor regarding audit of that company would be incorrect. Then that risk will be known as Audit Risk.

Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

(a) **Inherent risk**—The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. There is always a risk that before considering any existence of internal control in an entity, a particular transaction, balance of an account or a disclosure required to be made in the financial statements of an entity have a chance of being misstated and such misstatement can be material. This risk is known as Inherent Risk.

(b) **Control risk**—The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. Control Risk is a risk that internal control existing and operating in an entity would not be efficient enough to stop from happening, or find and then rectify in an appropriate time, any material misstatement relating to a transaction, balance of an account or disclosure required to be made in the financial statements of that entity. So in a way it can be said that there exists an inverse relation between Control Risk and Efficiency of Internal Control of an Entity. When efficiency of internal control of an entity is high the control risk is low and when efficiency of internal control of that entity is low the control risk is high.

STUDY MATERIAL NEW / EXAM NOV 20

Ques-5 "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

Ans. 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

STUDY MATERIAL NEW

Ques-6 "The auditor shall obtain an understanding of the control environment" Explain stating what is included in control environment.

Ans. The risk of material misstatement at assertion level comprises of two components i.e., inherent risk and control risk. Both inherent risk and control risk are the entity's risks and they exist independently of the audit of financial statements. Inherent risk and control risk are influenced by the client. These are entity's risks and are not influenced by the auditor.

Standards on auditing 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 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.

STUDY MATERIAL NEW

Ques-7 Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control.

Ans. **Objectives of Internal Control**

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

STUDY MATERIAL, RTP NOV 19, MTP MAY 20

Ques-8 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.

Ans. **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.

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:

- (a) **Communication and enforcement of integrity and ethical values** - These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
- (b) **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.

- (c) **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.
- (d) **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.
- (e) **Organisational structure** - The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
- (f) **Assignment of authority and responsibility** - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.
- (g) **Human resource policies and practices** - Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

STUDY MATERIAL OLD

Ques-9 Sweet Fruits Private Limited had a turnover of ₹ 155 crore for the financial year 2019-20. Explain whether during the financial year 2020-21, Sweet Fruits Private Limited would be required or not required to appoint an internal auditor, keeping in view the provisions of Companies Act, 2013.

Ans. During the financial year 2020-21, Sweet Fruits Private Limited would not be required to appoint an internal auditor because according to Section 138 of the Companies Act, 2013 every private company having a turnover of more than or equal to ` 200 crore during the preceding financial year is required to appoint an internal auditor. It is given in the question that Sweet Fruits Private Limited during the financial year 2018-19 had a turnover of ` 155 crore which is less than ` 200 crore. Therefore, during the financial year 2020-21, Sweet Fruits Private Limited will not be required to appoint an internal auditor.

EXAM MAY 18, RTP MAY 2023

Ques-10 Briefly discuss the limitations of internal control.

Ans. **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

EXAM MAY 18, RTP MAY 19, EXAM MAY 19

Ques-11 The auditor should understand and consider the risks that may arise from the use of information technology (IT) Systems.

Ans. IT poses specific risks to the Company's internal control, which include-

- (i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- (ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- (iii) The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- (iv) Unauthorised changes to data in master files.
- (v) Unauthorised changes to systems or programs.
- (vi) Failure to make necessary changes to systems or programs. Inappropriate manual intervention.
- (vii) Potential loss of data or inability to access data as required.

RTP MAY 19

Ques-12 (a) The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. Analyse and explain.

(b) So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. Explain stating clearly the benefits of evaluation of internal control to the auditor.

Ans. (a) Satisfactory Control Environment - not an absolute deterrent to fraud:

The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud. Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As explained in SA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures.

The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.

(b) So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operations of these internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

(B) Benefits of Evaluation of Internal Control to the Auditor

The review of internal controls will enable the auditor to know:

- (i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;
- (ii) whether an adequate internal control system is in use and operating as planned by the management;
- (iii) whether an effective internal auditing department is operating;
- (iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
- (v) whether the controls adequately safeguard the assets;
- (vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;
- (vii) how reliable the reports, records and the certificates to the management can be;
- (viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;
- (ix) what would be appropriate audit technique and the audit procedure in the given circumstances;
- (x) what are the areas where control is weak and where it is excessive; and
- (xi) Whether some worthwhile suggestions can be given to improve the control system.

RTP NOV 19

Ques-13 (a) Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk. Analyse and Explain.

(b) The extent and the nature of the audit programme is substantially influenced by the internal control system in operation. Analyse and explain.

Ans. (a) While obtaining audit evidence about the effective operation of internal controls, the auditor considers how they were applied, the consistency with which they were applied during the period and by whom they were applied. The concept of effective operation recognises that some deviations may have occurred. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. When deviations are detected the auditor makes specific inquiries regarding these matters, particularly, the timing of staff changes in key internal control functions. The auditor then ensures that the tests of control appropriately cover such a period of change or fluctuation.

Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk. The evaluation of deviations may result in the auditor concluding that the assessed level of control risk needs to be revised. In such cases, the auditor would modify the nature, timing and extent of planned substantive procedures. Before the conclusion of the audit, based on the results of substantive procedures and other audit evidence obtained by the auditor, the auditor should consider whether

the assessment of control risk is confirmed. In case of deviations from the prescribed accounting and internal control systems, the auditor would make specific inquiries to consider their implications. Where, on the basis of such inquiries, the auditor concludes that the deviations are such that the preliminary assessment of control risk is not supported, he would amend the same unless the audit evidence obtained from other tests of control supports that assessment. Where the auditor concludes that the assessed level of control risk needs to be revised, he would modify the nature, timing and extent of his planned substantive procedures.

It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Procedural tests simply mean testing of the compliance with the procedures laid down by the management in respect of initiation, authorization, recording and documentation of transaction at each stage through which it flows.

(b) The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to

ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.

It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed.

From the foregoing, it can be concluded that the extent and the nature of the audit programme is substantially influenced by the internal control system in operation. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance.

A proper understanding of the internal control system in its content and working also enables an auditor to decide upon the appropriate audit procedure to be applied in different areas to be covered in the audit programme.

In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

RTP MAY 20, MTP MARCH 2023

Ques-14 When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain

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

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

When a deficiency relates to an ineffective control that is the only control identified for an assertion, he revises risk assessment to 'not rely on controls' for associated assertions, as no other controls have been identified that mitigate the risk related to the assertion. If the deficiency relates to one WCGW (what can go wrong) out of several WCGW's, he can 'rely on controls' but performs additional substantive procedures to adequately address the risks related to the deficiency.

RTP MAY 20, RTP MAY 2023

Ques-15 (a) Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control.

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

Ans. (a) Objectives of Internal Control

Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting. For example, use of access

controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit. Conversely, safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit.

Objectives of Internal Control are :

- (i) transactions are executed in accordance with managements general or specific authorization;
- (ii) all transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;
- (iii) assets are safeguarded from unauthorised access, use or disposition; and
- (iv) The recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

(b) It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Procedural tests simply mean testing of the compliance with the procedures laid down by the management in respect of initiation, authorisation, recording and documentation of transaction at each stage through which it flows.

For example, the procedure for sales requires the following:

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

STUDY MATERIAL, RTP NOV 20

Ques-16 The risks of material misstatement may exist at the financial statement level and assertion level. Explain the two levels.

Ans. Risks of Material Misstatement at Two levels

The risks of material misstatement may exist at two levels:

- (i) **The overall financial statement level**- Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- (ii) **The assertion level for classes of transactions, account balances, and disclosures**-Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

MTP OCTOBER 20, MTP OCTOBER 21, MTP MARCH 2023, RTP MAY 2023

Ques-17 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.

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;

RTP NOV 20

Ques-18 A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls. Explain and also state when will the auditor design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls.

Ans. Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

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

- (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or
- (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

RTP NOV 20

Ques-19 When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Discuss the matters the auditor may consider in determining the extent of test of controls.

Ans. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls.

Matters the auditor may consider in determining the extent of test of controls include the following:

1. The frequency of the performance of the control by the entity during the period.
2. The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
3. The expected rate of deviation from a control.
4. The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
5. The extent to which audit evidence is obtained from tests of other controls related to the assertion.

RTP MAY 21

Ques-20 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.

Ans. The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting

are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

Benefits of Understanding the Internal Control

An understanding of internal control assists the auditor in:

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

RTP MAY 21, MTP MARCH 2022

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

Or

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.

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

- Materiality.
- The significance of the 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.

RTP MAY 21, MTP APRIL 2022

Ques-22 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.

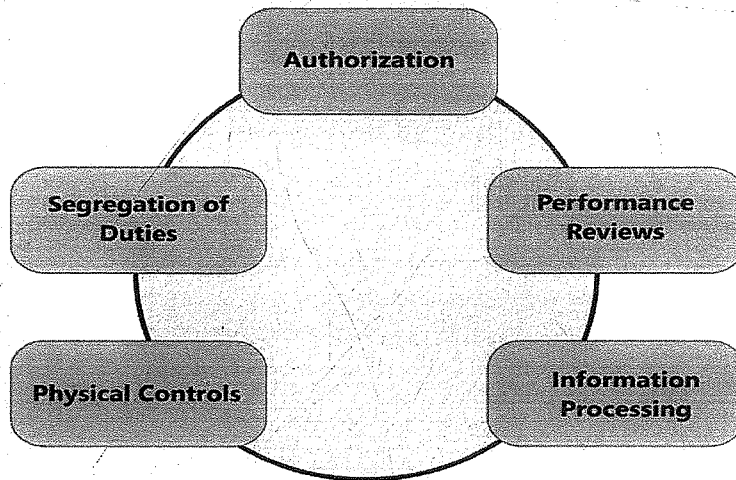
Ans. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following are as:

- (a) The classes of transactions in the entity's operations that are significant to the financial statements;
- (b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;
- (d) How the information system captures events and conditions that are significant to the financial statements;
- (e) The financial reporting process used to prepare the entity's financial statements;
- (f) Controls surrounding journal entries.

RTP MAY 21

Ques-23 The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. Explain in detail stating clearly the meaning of control activities and also discuss control activities that are relevant to the audit..

Ans. The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process. Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.



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

Control activities that are relevant to the audit are:

- Control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or
- Those that are considered to be relevant in the judgment of the auditor;
- As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

RTP NOV 21

Ques-24 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.

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

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

- Greater management intervention to specify the accounting 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

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

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

EXAM DEC 21

Ques-25 Auditor of Sunshine Ltd. is of the view that due to greater management intervention to specify accounting treatment, the risk of material misstatement is greater for non-routine transactions. Is the view of the auditor correct? Specify the other matters due to which the risk of material misstatement is greater for significant non - routine transactions.

Ans. Risk of Material Misstatement - Greater for Significant Non-Routine Transactions: Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.

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:

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

Keeping in view above, view of Auditor of Sunshine Ltd is correct.

MTP OCT 2022

Ques-26 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.

Ans: **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.

MTP OCT 2022

Ques-27 Explain the objective and enlist the activities involved in the General IT Controls over "Program Change".

Ans: 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

MTP SEPT 2022

Ques-28 The auditor should consider relevance of IT in an audit of financial statements. Explain giving reasons.

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

- (i) Since auditors rely on the reports and information generated by IT systems, there could be risk in the IT systems that could have an impact on audit.
- (ii) Standards on auditing SA 315 and SA 330 require auditors to understand, assess and respond to risks that arise from the use of IT systems.
- (iii) By relying on automated controls and using data analytics in an audit, it is possible to increase the effectiveness and efficiency of the audit process.

RTP MAY 2022

Ques-29 Generally, IT benefits an entity's internal control by enabling an entity to enhance the timeliness, availability, and accuracy of information. Discuss explaining the other relevant points in the above context.

Ans. Generally, IT benefits an entity's internal control by enabling an entity to:

- (i) Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
- (ii) Enhance the timeliness, availability, and accuracy of information;
- (iii) Facilitate the additional analysis of information;
- (iv) Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
- (v) Reduce the risk that controls will be circumvented; and
- (vi) Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

RTP MAY 2022

Ques-30 While conducting the audit of Smart TV Ltd, engagement team of HTR & Co, has considered materiality and audit risk throughout the audit. Discuss explaining the meaning of audit risk.

Ans. Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

- (a) Identifying and assessing the risks of material misstatement;
- (b) Determining the nature, timing and extent of further audit procedures; and
- (c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

EXAM NOV 2022

Ques-31 Z Ltd. is a manufacturer of ready - made garments . During the year 2021-22 , they have opened two new branches and there is a substantial increase in their sales . The management has appointed CA R to review the internal control system of the company as they feel that there are lapses in the control environment of the company . What is included in the control environment and what will the auditor evaluate in order to obtain an understanding of the control environment?

Ans. 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.

The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

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

EXAM MAY 2023

Ques-32 You are appointed as an auditor of Gama Ltd. Your audit assistant wants to understand the meaning of Audit Risk, Explain him the meaning of Audit Risk with example. Also guide him as to what is not included in Audit Risk

Ans: **Audit risk** means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment.

Example

Gama Limited purchased a Plant and Machinery for ` 2 Crores in the financial year 2021-2022. The accountant of Gama limited debited ` 2 crores in the repair and maintenance account in the statement of Profit and loss instead of taking it to the balance sheet as PPE and claim depreciation on it. While auditing the accounts of this company the auditor may not notice this and consequently may not report anything regarding the plant and machinery. Therefore, opinion given by the auditor would be inappropriate resulting in audit risk.

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.

RTP NOV 2023

Ques-33 There is direct relationship between detection risks and the combined level of inherent and control risks.

Ans: There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high, acceptable detection risks need to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risk to an acceptably low level.

RTP NOV 2023

Ques-34 Control Environment can prevent, detect and correct a material misstatement

Ans: The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of risks of material misstatement.

RTP NOV 2023

Ques-35 Risk of material misstatement refers to the risk that the financial statements are materially misstated prior to audit. Discuss the levels at which this risk exists.

Ans: **The risks of material misstatement may exist at two levels:**

- (i) **The overall financial statement level** - Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- (ii) **The assertion level for classes of transactions, account balances, and disclosures** - Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

RTP NOV 2023

Ques-36 When a business operates in a more automated environment. We are likely to see several business functions and activities happening within the systems. List down the business functions and activities happening within the systems.

Ans: **Relevance of Information Technology in an Audit:** When a business operates in a more automated environment it is likely that we will see several business functions and activities happening within the systems.

Following are such types of functions and activities:

- (i) Computation and Calculations are automatically carried out (for example, bank interest computation and inventory valuation).
- (ii) Accounting entries are posted automatically (for example, sub-ledger to GL postings is automatic).
- (iii) Business policies and procedures, including internal controls, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
- (iv) Reports used in business are produced from systems. Management and other stakeholders rely on these reports and information produced (for example, debtors ageing report).
- (v) User access and security are controlled by assigning system roles to users (for example, segregation of duties can be enforced effectively).

PYQ NOV 2023

Ques-37 Elucidate the impact on substantive audit if IT related risks are not mitigated in an automated environment.

Chapter - 4 Audit Evidence

✚ Questions Discussed in the Chapter of SA

Chapter - 5

Audit of Financial Statements

STUDY MATERIAL NEW

Ques-1 How will you vouch and/or verify the following:

- (a) Goods sent out on Sale or Return Basis.
- (b) Borrowing from Banks.

Ans. (a) **Goods Sent Out on Sale or Return Basis:**

- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
- (ii) Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
- (iii) Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
- (iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.

(b) **Borrowing from Banks: Borrowing from banks may be either in the form of overdraft limits or term loans.** In each case, the borrowings should be verified as follows-

- (i) Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
- (ii) Obtain independent balance confirmation from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
- (iii) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
- (iv) Confirm, in the case of a company, that the restraint contained in Section 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.

Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

STUDY MATERIAL NEW

Ques-2 How will you vouch/verify the following:

- (a) Goods sent on consignment.
- (b) Foreign travel expenses.
- (c) Receipt of capital subsidy.
- (d) Provision for income tax.

Ans. (a) **Goods Sent on Consignment:**

- (i) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.
- (ii) Reconcile the figure of the goods on hand, as given in the last accounts sales, with the Performa invoices and accounts sales received during the year. If any consignment inventory was in the hands of the consignee at the beginning of the year, the same should be taken into account in the reconciliation.
- (iii) Obtain confirmation from the consignee for the goods held on consignment on the balance sheet date. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.
- (iv) Ensure that the quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues, customs due, etc., unless the value is lower. In case net realisable

value is lower, the inventory in hand of the consignee should be valued at net realisable value. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.

(v) See that goods in hand with the consignee have been shown separately under the head inventories.

(b) Foreign Travel Expenses:

(i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.

(ii) Verify that the tour programme was properly authorised by the competent authority.

(iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.

(iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.

(v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".

(c) Receipt of Capital Subsidy:

(i) Check the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.

(ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.

(iii) Ensure that the conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.

(iv) Check relevant entries for receipt of subsidy.

(v) Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

(d) Provision for Income Tax:

(i) Obtain the computation of income and income tax prepared by the entity and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.

(ii) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.

(iii) Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.

(iv) Compute tax payable as per the latest applicable rates in the Finance Act.

(v) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.

(vi) Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under

STUDY MATERIAL NEW / RTP NOV 21

Ques-3 How will you vouch and/or verify payment of taxes?

Ans. Vouching of Payment of Taxes:

(i) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.

(ii) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.

(iii) The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.

(iv) Nowadays, electronic payment of taxes is also in trend. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.

- (v) The entity can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. This should be checked by the auditor.
- (vi) It is not necessary for the entity to make payment of taxes from his own account in an authorized bank. While vouching such e-payment, the auditor should cross verify the payments of taxes through the receipted challan along with PAN No /TAN No. etc.

STUDY MATERIAL NEW / RTP NOV 21

Ques-4 How would you vouch/verify the following:

- (a) Advertisement Expenses.
 (b) Sale of Scrap.

Ans. (a) **Advertisement Expenses:**

- (i) Verify the bills/invoices from advertising agency to ensure that rates charged for different types of advertisement are as per the contract.
 (ii) See that the advertisement relates to client's business.
 (iii) Inspect the receipt issued by the agency.
 (iv) Ascertain the nature of expenditure - revenue or capital expenditure and see that it has been recorded properly.
 (v) Ascertain the period for which payment is made and see that prepaid amount, if any, is carried to the balance sheet.
 (vi) See that all outstanding advertisement bills have been provided for.

(b) **Sale of Scrap:**

- (i) Review the internal control as regards generation, storage and disposal of scrap.
 (ii) Check whether the organization is maintaining reasonable record for generation of scrap.
 (iii) Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
 (iv) Check the rates at which scrap has been sold and compare the rate with previous year.
 (v) Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
 (vi) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
 (vii) Make an overall assessment of the value of realization from scrap as to its reasonableness

STUDY MATERIAL NEW

Ques-5 ABC Ltd. has issued shares for cash at a premium. Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account. Advise the means in which the amount in the account can be applied

Ans. **Shares Issued at Premium:** In case a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or otherwise, section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account and state the means in which the amount in the account can be applied. As per the section, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

Application of securities premium account: The securities premium account may be applied by the Company:

- (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.

The auditor needs to verify whether the premium received on shares, if any, has been transferred to a "securities premium account" and whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above

STUDY MATERIAL NEW

Ques-6 The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Ans. 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, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

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.

STUDY MATERIAL NEW / MTP NOV 21

Ques-7 Write the audit Procedure for verification of existence of Trade Receivables.

Ans. For Verification of Existence of Trade Receivables, the auditor should check the following :

i. Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice.

Ask for a period-end accounts receivable ageing report and trace the balance as per the report to the general ledger.

ii. Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first.

iii. If any large balance is due for a long time, auditor should ask for reasons and justification for the same.

iv. A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed.

v. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.

vi. Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample.

vii. Where no reply is received, the auditor should perform alternate procedures regarding the balances.

viii. Agreeing the balance to cash received subsequently;

ix. Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. (examination in depth for those balances)

x. If there are any related party receivables, review them for collectability as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.

xi. Check that receivables for other than sales or services are not included in the list.

xii. Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e. perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.

STUDY MATERIAL NEW

Ques-8 MNO & Associates are the statutory auditor of Venus Ltd. for the FY 2021 -22. During the course of audit, one of the audit team members, Mr. Viaan noticed that the company has made loans totalling to ` 50 lakhs to the promoters of the company, namely, Mr. Raj and Mr. Rajeev without specifying the period of repayment. Mr. Viaan discussed with Mr. Manik, the engagement partner, about the disclosure requirements with respect to such loans required by Schedule III to the Companies Act, 2013. What should Mr. Manik advise Mr. Viaan?

	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		

Ans. Mr. Manik should advise Mr. Viaan to consider whether the following disclosures as required by Schedule III to the Companies Act, 2013, has been made in respect of the loans granted to promoters, namely, Mr. Raj and Mr. Rajeev, either severally or jointly with any other person, that are:

- (a) repayable on demand or
- (b) without specifying any terms or period of repayment

STUDY MATERIAL NEW

Ques-9 What are the disclosures requirements as per Part I of Schedule III to the Companies Act with respect to the cash & cash equivalents held by a company?

Ans. The following are the disclosure requirements as per Schedule III to the Companies Act, 2013, with respect to the cash & cash equivalents held by the company:

Cash and cash equivalents

(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.

STUDY MATERIAL NEW

Ques-10 Mercury Ltd. is a company engaged in the manufacture of floor mats. The company sells its goods on credit. The debtors balance as on 31.03.2022 amounted to ` 20 cr. What is the disclosure requirement as per Schedule III to the Companies Act 2013, with respect to the ageing schedule of debtors of the company?

Ans. The following are the disclosure requirement as per Schedule III to the Companies Act 2013, with respect to the ageing schedule of debtors of the company:

Trade Receivables ageing schedule

Particulars	Outstanding for following periods from due date of payment#					(Amount in `)	
	Less than 6 months	6 months - 1 year	1-2 years	2-3 years	More than 3 years	Total	
(i)Undisputed Trade receivables-considered good							
(ii)Undisputed Trade Receivables-considered doubtful							
(iii)Disputed Trade Receivables considered good							
(iv)Disputed Trade Receivables considered doubtful							

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.
 Unbilled dues shall be disclosed separately.

STUDY MATERIAL NEW

Ques-11 You are the statutory auditor of Jupiter Ltd. for the FY 2022-23. During the course of audit, you noticed that the company has PPE under construction i.e. Capital Work in Progress. What disclosures should the company give with respect to the ageing schedule of such capital work in progress as required by Schedule III to the Companies Act, 2013?

Ans. Capital-Work-in Progress

(a) For Capital-work-in progress, following ageing schedule shall be given:

CWIP	Amount in CWIP for a period of				Total*
	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

(b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given**:

(Amount in `)

CWIP	To be completed in			
	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

STUDY MATERIAL NEW

Ques-12 The auditor of Saturn Ltd. wants to verify whether the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2023. What audit procedures should the statutory auditor of the company perform?

Ans. The statutory auditor of Saturn Ltd. should perform the following audit procedures to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2023.

The auditor should:

- ✚ vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
- ✚ evaluate the consigned goods.
- ✚ examine client correspondence, sales and receivables records, purchase documents.
- ✚ determine existence of collateral agreements.
- ✚ review consignment agreements.
- ✚ review material purchase commitment agreements.
- ✚ examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.
- ✚ obtain confirmation for significant items of inventory.

For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

STUDY MATERIAL NEW

Ques-13 Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

Ans. Matters relevant in planning attendance at physical inventory counting include, for example:

- (a) Nature of inventory.
- (b) Stages of completion of work in progress.
- (c) The risks of material misstatement related to inventory.
- (d) The nature of the internal control related to inventory.
- (e) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- (f) The timing of physical inventory counting.
- (g) Whether the entity maintains a perpetual inventory system.
- (h) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
- (i) Whether the assistance of an auditor's expert is needed.

STUDY MATERIAL, EXAM NOV 20

Ques-14 Discuss the audit procedures generally required to be undertaken by the auditor while auditing Goods sent out on sale or Return Basis

Ans. The audit procedure generally required to be undertaken by the auditor while auditing Goods sent out on Sale or Return Basis is as under:

- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
- (ii) Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
- (iii) Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
- (iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.

STUDY MATERIAL, EXAM MAY 18, EXAM NOV 18, EXAM DEC 21

Ques-15 "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 attributers" Mention those attributes

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

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

EXAM MAY 18, EXAM NOV 20

Ques-16 ABC Limited appointed XYZ & Company Chartered Accountants as a Statutory Auditor of the Company for the year 2019-20. CA. X, Partner of XYZ & Company was looking after the audit of other income of the company which consists of interest income on fixed deposits. As a Statutory Auditor how would CA. X verify interest income on fixed deposits for the year 2019-20?

Ans. CA X, partner of XYZ & Company, would carry out the following audit procedure for verifying interest income on fixed deposits of ABC Limited:

1. Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period. Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.
2. For deposits still outstanding as at the period-end, trace the same to the direct confirmations obtained from the respective bank/ financial institution.
3. Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity.
4. Also, obtain a copy of Form 26AS (TDS withholding by the bank/ financial institution) and reconcile the interest reflected therein to the calculation shared by client.

EXAM MAY 18, EXAM JAN 21

Ques-17 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

Ans. 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;
 - (ii) It is probable that the economic benefits associated with the dividend will flow to the entity; and
 - (iii) 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.

EXAM MAY 18, MTP APRIL 21

Ques-18 Discuss the following:

(a) 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.

Ans. (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.

EXAM NOV 18

Ques-19 Briefly mention the matters that are relevant in planning attendance at physical inventory counting.

Ans. Matters relevant in planning attendance at physical inventory counting: Matters relevant in planning attendance at physical inventory counting include, for example:

- (i) Nature of inventory.
- (ii) Stages of completion of work in progress.
- (iii) The risks of material misstatement related to inventory.
- (iv) The nature of the internal control related to inventory.
- (v) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- (vi) The timing of physical inventory counting.
- (vii) Whether the entity maintains a perpetual inventory system.
- (viii) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
- (ix) Whether the assistance of an auditor's expert is needed.

RTP MAY 19, MTP NOV 21

Ques-20 Explain the audit procedure to vouch/verify:

- (i) Power and Fuel expenses.

OR

The auditor may choose to analyse the monthly trend for Power & Fuel expense. Explain how this analysis will be performed by the auditor

Ans. Power and fuel expense-

Obtain a month wise expense schedule along with the power bills.

Verify if expense has been recorded for all 12 months.

Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis.

In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends

RTP MAY 19

Ques-21 Reserves are amounts appropriated out of profits whereas on the contrary, provisions are amounts charged against revenue. Discuss explaining the difference between the two and also explain clearly revenue reserve and capital reserve.

Ans. Reserves are 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.

On the contrary, provisions are amounts charged against revenue to provide for:

(i) Renewal or diminution in the value of assets; or

(ii) a known liability, the amount whereof could only be estimated and cannot be determined with accuracy; or

(iii) a claim which is disputed.

Amounts contributed or transferred from profits to make good the diminution in value of assets due to the fact that some of them have been lost or destroyed as a result of some natural calamity or debts have proved to be irrecoverable are also described as provisions. Provisions are normally charged to the Statement of Profit and Loss before arriving at the amount of profit. Reserves are appropriations out of profits.

Difference between Reserves and Provisions

The difference between the two is that provisions are amounts set aside to meet specific/ identified liabilities or diminution in recoverable value of assets. These must be provided for regardless of the fact whether the Company has earned profit or not.

Reserves on the other hand, represent amounts appropriated out of profits, held for equalizing the dividends of the company from one period to another or for financing the expansion of the company or for generally strengthening the company financially.

If we examine the Balance Sheet of a company, at a given time, and deduct the total liabilities to outside trade payables from the value of assets shown therein, the difference between the two figures will represent the net worth of the company based on the book values of assets as on that date. The same shall include the capital contributed by the shareholders as well as total undistributed profit held either to the credit of the Statement of Profit and Loss or to reserves; the reserves again will be segregated as revenue or capital reserves.

Revenue reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose

Examples- 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, on the other hand represents a reserve which does not include any amount regarded as free for distribution through the Statement of Profit and Loss

Examples- share 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.

A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.

EXAM MAY 19, EXAM NOV 19

Ques-22 While auditing purchases which types of analytical procedures will be performed by the auditor to obtain audit evidence as to overall reasonableness of purchase quantity and price

Ans. Analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price may include:

- (i) Consumption Analysis: Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from Management If any significant variations found.
- (ii) Stock Composition Analysis: Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.
- (iii) Ratios: Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.
- (iv) Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and Consumption.

EXAM MAY 19

Ques-23 While reviewing Employee benefits expenses of a company how you as an auditor you will valuate its hiring appraisal and retirement process?

Ans. While reviewing Employee Benefits expenses auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:

- (i) The auditor first tests the controls the company has set around the employee benefit payment process to determine how strong and reliable they are. If they are strong, the auditor can minimize the amount of transaction testing he must do. A common internal control over the employee benefit payment cycle includes maintaining of attendance records, authorisation and approval of monthly payroll processing and disbursement.
- (ii) The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.
- (iii) The auditor performs Substantive analytical procedure consisting of monthly expense reasonability, comparison with previous accounting period, any analysis auditor may find relevant and most important of all setting an expectation in relation to the expense incurred during the period under audit and compare that with the client's business operations and overall trend in the industry.

STUDY MATERIAL, EXAM MAY 19

Ques-24 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 comment

Ans. It is not correct to say that 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, other purposes for which securities premium account can be applied are-

- (i) in writing off the preliminary expenses of the Company;
- (ii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (iii) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (iv) For the purchase of its own shares or other securities under section 68.

STUDY MATERIAL, RTP NOV 19, EXAM DEC 21

Ques-25 The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Ans. 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, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

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 the PPE that has been given as security to any third parties

RTP NOV 19

Ques-26 Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period- end.

Ans Since an Intangible Asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.

Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.

In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion

EXAM NOV 19

Ques-27 Validity and consequence of issue of shares at discount check with respect to the provisions of the Companies Act, 2013.

Ans. Shares issued at discount:

(i) As per section 53 of the Companies Act, 2013, a company shall not issue share at a discount, except in the case of an issue of sweat equity shares given under section 54 of the Companies Act, 2013. Any share issued by a company at a discounted price shall be void.

(ii) The auditor needs to 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)

Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees: and

(iv) every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees, or with both.

MTP MAY 20

Ques-28 Krishna Cycles Ltd. is engaged in manufacturing of different type of Bicycles. On going 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 you would proceed as an auditor.

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

- (1) 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
- (2) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results

MTP MAY 20, MTP APRIL 21

Ques-29 "P India" Ltd. is a manufacturer of various sports products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims, which may give rise to risk of material misstatements. Suggest the audit procedures in the given case.

Ans. The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- (i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- (ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (iii) Reviewing legal expense accounts.

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.

MTP MAY 20, EXAM NOV 18

Ques-30 Write the audit procedures to be performed as an auditor for valuation (assertion) of following:

- (i) Loans and Advances and other current assets.
- (ii) Finished goods and goods for resale.

(I) Audit procedure for valuation of Loans and Advances and other current assets

1. Assess the allowance for doubtful accounts. Review the process followed by the Company to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.
2. Obtain the ageing report of loans and advances, split between not currently due, 30 days old, 30-60 days old, 60-180 days old, 180-365 days old and more than 365 days old. Also, obtain the list of loans and advances under litigation and compare with previous year.
3. Scrutinize the analysis and identify those loans and advances that appear doubtful; Discuss with management their reasons, if any of these loans/ advances are not included in the provision for bad recoverable; perform further testing where any disputes exist; Reach a final conclusion regarding the adequacy of the bad and doubtful loans/ advances provision.

4. Assess bad loans/ advances write-offs. Prepare schedule of movements on Bad loans/ advances - Provision Accounts and loans/ advances written off.
5. Check that write-offs or other reductions in the recoverable balances have been approved by an appropriate and authorised member of senior management, for example the financial controller or finance director.
6. Check that the restatement of foreign currency loans and advances/ other current assets has been done properly.

(ii) Audit procedure for valuation of finished goods and goods for resale

1. Enquire into what costs are included, how these have been established and ensure that the overheads included have been determined based on normal costs and appear reasonable in relation to the information disclosed in the draft financial statements.
2. Ensure that inventories are valued at net realizable value if they are likely to fetch a value lower than their cost. For any such items, also verify if the relevant semi/ partly processed inventories (work in progress) and raw materials have also been written down.
3. Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items. For the purpose, request the client to provide inventory ageing split between less than 30 days, 30-60 days old, 60-90 days old, 90-180 days old, 180-365 days old and more than 365 days old (refer screenshot below).
4. Follow up any inventories which at time of observance of physical counting were noted as being damaged or obsolete.
5. Compare recorded costs with replacement costs. Examine vendor price lists to determine if recorded cost is less than current prices.
6. Calculate inventory turnover ratio. Obsolete inventory may be revealed if ratio is significantly lower.
7. In manufacturing environments, test overhead allocation rates and ensure that only direct labour, direct material and overhead have been included.
8. Verify the correct application of lower-of-cost-or-net realizable value principles.

RTP MAY 20

Ques-31 Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. Explain with example stating the relevant assertions involved in this regard. Also explain financial statement audit.

Ans. Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS).

A financial statement audit comprises the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the truth and fairness of presentation of the financial statements and related disclosures.

In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding:

- completeness;
- cut-off;
- existence/ occurrence;
- valuation/ measurement;
- rights and obligations; and
- presentation and disclosure

of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards.

Example - If Company X's balance sheet shows building with carrying amount of ₹ 50 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet exists as at the period- end (existence assertion);

- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of ₹ 50 lakh (Completeness assertion).

RTP MAY 20

Ques-32 What does the Valuation assertion mean in respect of Assets, liabilities and equity balances? Explain with the help of example in respect of Inventory.

Ans. Meaning of Valuation Assertion- Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

Example of Inventory explaining the valuation assertion is given hereunder: Inventory has been recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories. Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (e.g. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.

MTP OCTOBER 20

Ques-33 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.

Ans. 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

RTP NOV 20

Ques-34 How will you vouch/verify the following?

- (a) Trademarks and copyrights
- (b) Investments income in the case of charitable institutions
- (c) Contingent liabilities
- (d) Leasehold rights

Ans. **Trademarks and Copyrights:**

- (i) Obtain schedule of Trade Marks and Copyrights duly signed by the responsible officer and scrutinise the same and confirm that all of them are shown in the Balance Sheet.

(ii) Examine the written agreement in case of assignment of Copyrights and Assignment Deed in case of transfer of trade marks. Also ensure that trademarks and copyrights have been duly registered.

(iii) Verify existence of copyright by reference to contract between the author & the entity and note down the terms of payment of royalty.

(iv) See that the value has been determined properly and the costs incurred for the purpose of obtaining the trademarks and copyrights have been capitalised.

(v) Ascertain that the legal life of the trademarks and copyrights has not expired.

(vi) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations, as per the principles enunciated under AS 26 on Intangible Assets.

Investment Income in the case of Charitable Institution:

(i) Vouching the amounts received with the dividend and interest counterfoils.

(ii) Checking the calculations of interest received on securities bearing fixed rates of interest.

(iii) Checking that the appropriate dividend has been received where any investment has been sold ex-dividend or purchased cum-dividend.

(iv) Comparing the amounts of dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.

Contingent liabilities:

(i) Inspect the minute books of the company to ascertain all contingent liabilities known to the company.

(ii) Examine the contracts entered into by the company and the likelihood of contingent liabilities emanating therefrom.

(iii) Scrutinise the lawyer's bills to track unreported contingent liabilities.

(iv) Examine bank letters in respect of bills discounted and not matured.

(v) Examine bank letters to ascertain guarantees on behalf of other companies or individuals.

(vi) Discuss with various functional officers of the company about the possibility of contingent liability existing in their respective field.

(vii) Obtain a certificate from the management that all known contingent liabilities have been included in the accounts and they have been properly disclosed.

(viii) Ensure that proper disclosure has been made as per Schedule III to the Companies Act, 2013 and AS 29, "Provisions, Contingent Liabilities and Contingent Assets".

Leasehold Rights:

(i) Inspect the lease or assignment thereof to ascertain the amount of premium, if any, for securing the lease, and its terms and conditions; and that the lease has been duly registered. A lease exceeding one year is not valid unless it has been granted by a registered instrument.

(ii) Ascertain that all the conditions, the failure to comply with which might result in the forfeiture or cancellation of the lease, e.g., payment of ground rent on the due dates, insurance of property, its maintenance in a satisfactory state of repairs, etc. prescribed by the lease, are being duly complied with.

(iii) Examine the counterpart of the tenants' agreements, if part of the leasehold property has been sublet.

(iv) Make certain that due provisions for any claim that might arise under the dilapidation clause on the expiry of the lease has been made, and, if no such provision has been made, draw the client's attention to the matter.

(v) Ensure that the outlay as well as any legal expenses incurred to acquire the leases which are shown as an asset in the Balance Sheet is being written off at a rate which could completely wipe off the asset over the unexpired term of the lease.

RTP NOV 20

Ques-35 A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, etc. as at the end of the reporting period under audit. Explain the audit procedure in this context.

Ans. **Direct confirmation procedure**

A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, restrictive

use accounts like dividend, escrow accounts as of the end of the reporting period under audit. This should necessarily be done for all account balances as at the period-end.

The Company should be asked to investigate and reconcile the discrepancies, if any, including seeking written explanations/ clarifications from the banks/ financial institutions on any unresolved queries.

The auditor should emphasize for confirmation of 100% of bank account balances. In remote situations, where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:

- Agreeing the balance to bank statement received by the Company or internet/ online login to account in auditor's personal presence;
- Sending the audit team member to the bank branch along with the entity's personal to obtain balance confirmation from the bank directly.

EXAM JAN 21

Ques-36 ABC Limited has a closing balance of work in progress of inventories aggregating ₹ 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

Ans. 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 here under :

- (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.

EXAM JAN 21

Ques-37 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.

Ans. 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 amortisation 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.

MTP MARCH 21

Ques-38. (a) State assertions that are implied in the extract of financial statement given below:

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

Ans (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.

MTP MARCH 21

Ques-39 Auditor of ABC Ltd while auditing its financial statements wants to ensure whether the disclosures regarding sales has been made as required under Schedule III (Part 1) to Companies Act, 2013. Explain such disclosure requirements.

Ans. With respect to sales of the client entity, the auditor is required to ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:

1. Whether disclosure of sales in respect of each class of goods has been made.

2. Whether revenue from operations is disclosed separately in the notes as revenue arising from:

✓ Sale of products (including excise duty)

✓ Sale of services

✓ Other operating revenues.

3. Whether brokerage and discount on sales other than usual trade discount has been disclosed.

4. Whether the transactions with related parties are appropriately disclosed in notes to accounts.

MTP OCTOBER 20, MTP MARCH 21, EXAM MAY 19, MTP APRIL 2023

Ques-40 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.

OR

You are an auditor of Jagat Ltd. which has spent ₹ 15 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.

Ans. 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.

RTP MAY 21

Ques-41. List out the steps to be taken by auditor while vouching/ verifying the 'Refund of General Insurance premium paid'.

Ans. Refund of General Insurance Premium paid: The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds:

- (i) Ascertain the reasons for refund of insurance premium.
- (ii) Examine insurance policy or cover note to find out the amount of premium.
- (iii) Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.
- (iv) Scrutinise correspondence between the insurance company and the client.
- (v) Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.

RTP MAY 21, EXAM MAY 18

Ques-42. 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.

Ans. 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 capitalized 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.

RTP MAY 21, MTP MAY 20, MTP APRIL 21

Ques-43 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.

Ans. 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

EXAM JULY 21

Ques-44 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.

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

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

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

EXAM JULY 21

Ques-45. 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?

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

- Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
- Test checks 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 yearend 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.)

MTP OCTOBER 21

Ques-46. 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 he will verify them.

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

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

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

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

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

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

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

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

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

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

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

MTP NOVEMBER 21

Ques-47. 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?

Ans. Examples of costs to be excluded in determining cost of Inventory:

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

(i) abnormal amounts of wasted materials, labour, or other production costs;

(ii) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(iii) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(iv) selling and distribution costs.

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

RTP NOV 21, RTP MAY 2022

Ques-48. 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

OR

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

Ans. (a) **Recovery of Bad Debts written off: 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) Ascertain whether the organisations is maintaining reasonable records for the sale and disposal of scrap materials.
- (iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.
- (iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.
- (v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
- (vi) See that scrap materials sold have been billed and check the calculations on the invoices.
- (vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it and sold as scrap
- (viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

RTP NOV 21

Ques-49. APQ Ltd. deals in real estate and classifies all of its land holding under current assets as inventory. The same is, therefore valued at cost or market value whichever is less. How would you verify profit or loss arising on sale of plots of land by such a dealer?

Ans. Verification of Profit & Loss Arising on sale of Plots by real estate dealer: The land holding in the case of real estate dealer will be a current asset and not a fixed asset. The same should, therefore, be valued at cost or market value whichever is less. The amount of profit or loss arising on sale of plots of land by such a dealer should be verified as follows:

- (i) Each property account should be examined from the beginning of the development with special reference to the nature of charges so as to find out that only the appropriate cost and charges have been debited to the account and the total cost of the property has been set off against the price realised for it.
- (ii) This basis of distribution of the common charges between different plots of land developed during the period, and basis for allocation of cost to individual properties comprised in a particular piece of land should be scrutinised.
- (iii) If land price lists are available, these should be compared with actual selling prices obtained. And it should be verified that contracts entered into in respect of sale have been duly sanctioned by appropriate authorities.
- (iv) Where part of the sale price is intended to reimburse taxes or expenses, suitable provisions should be maintained for the purpose.
- (v) The prices obtained for various plots of land sold should be checked with the plan map of the entire tract and any discrepancy or unreasonable price variations should be inquired into. The sale price of different plots of land should be verified on a reference to certified copies of sale deeds executed.
- (vi) Out of the sale proceeds, provision should be made for the expenditure incurred on improvement of land, which so far has been accounted for.

EXAM DEC 21

Ques-50. How is " Cash and cash equivalents " disclosed in the Financial Statements as required under Schedule III (part 1) to Companies Act , 2013 ?

Ans. 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) Cheque, drafts on hand;
- (c) Cash on hand;
- (c) 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.

EXAM DEC 21

Ques-51. Profit and Loss account of an organization shows various types of expenses like rent, power and fuel, repairs and maintenance, insurance, traveling, 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?

Ans. 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.

EXAM DEC 21, MTP APRIL 2023

Ques-52. 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 evidence 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

Ans. **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 personnel

(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 immoveable properties held as at the balance sheet date.

- (iv) 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, 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 immoveable 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.

MTP MARCH 2022, RTP MAY 2022

Ques-53. 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.

Ans. 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.

MTP MARCH 2022

Ques-54 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.

Ans. 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.

MTP OCT 2022

Ques-55 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.

Ans: 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.

MTP OCT 2022

Ques-56 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.

Ans: 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.

MTP OCT 2022

Ques-57 Explain how you would verify rent expense incurred by a company.

Ans: 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

MTP SEPT 2022

Ques-58 Explain how you would verify employee benefit expense incurred by a company.

Ans: **The auditor shall verify that:**

- 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.
- Employee benefit expenses in respect of all personnel have been fully accounted for.
- Employee benefit expenses recognized during the period relates to the current accounting period only.
- 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.

MTP SEPT 2022

Ques-59 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.

Ans: 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.

RTP MAY 2022

Ques-60. Pachranga International Ltd is manufacturer of pickles, ginger garlic paste, jams etc having its plant at Jaipur. Being in food industry, the company is facing many litigations in various courts across India. Auditors SPV & Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose.

Ans. The auditor SPV & Co. shall design and perform audit procedures in order to identify litigation and claims involving the entity (Pachranga International Ltd) which may give rise to a risk of material misstatement, including:

- (i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.
- (ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (iii) Reviewing legal expense accounts.

EXAM MAY 2022, MTP APRIL 2023

Ques-61 B Ltd. is covered w / 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?

Ans. 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

EXAM MAY 2022

Ques-62 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?

Ans. 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.

EXAM MAY 2022

Ques-63 Proceedings have been initiated against False Limited for holding benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, but such property is not recorded in books of accounts. As a consultant to the company. What will you advice to the company, what will you advice to the company as far as disclosure requirements are concerned in relation to said proceeding?

Ans. 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 Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, 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 an abettor 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.

EXAM NOV 2022

Ques-64 S & Co. Chartered Accountants, are appointed as the auditors of ABC Ltd. CA S, the engagement partner, has come across the following while verifying equity share capital of the company: Fil 30 bali

- (i) He noticed that some of the equity shares are held by promoters.
- (ii) Some shares are issued as sweat equity shares to the employees 4 What is the meaning of sweat equity shares? What are the disclosure requirements of such promoter's shareholding?

Ans. Meaning of Sweat Equity & Disclosure of shares held by Promoters:

Meaning Sweat Equity Shares: According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'.

"Sweat Equity Shares" mean equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

Disclosure requirements of such promoter's shareholding: A company shall disclose Shareholding of Promoters* as below:

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Shares held by promoters at the end of the year				% Change during the year***
S. No.	Promoter Name	No. of shares	% of total shares**	

* Promoter here means promoter as defined in the Companies Act, 2013.

** Details shall be given separately for each class of shares.

*** percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.]

EXAM NOV 2022

Ques-65 M / s SS & Associates have been appointed as statutory auditors of Green Limited, a company engaged in the business of manufacturing of hardware products. They are analyzing the monthly trends for other expenses like rent, power and fuel, repairs, etc. and are also verifying attributes of such types of expenses. List down the attributes for verifying such expenses.

Ans. Attributes for verifying other expenses like Power and Fuel, Repair etc.:

An entity in addition to making purchases and incurring employee benefit expenses, also incurs other expenditures like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations.

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:

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

EXAM NOV 2022

Ques-66 While auditing books of accounts of SOLAR Ltd., you observed that an amount due from a debtor for invoice issued on 31.03.2022 has not been recognized in the books of accounts. As an auditor, you want to ensure that all trade receivable balances that are supposed to be recorded have been recognized in the financial statements. How will you achieve the stated objective?

Ans. Audit of Trade Receivable:

All Trade receivable balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS): The auditor needs to satisfy himself of the cut-offs. Without a cut-off, sales could be understated or overstated, hence there is a need to perform the following cut off procedure:

- For the invoices issued during the last few days (last 5 days of the reporting year) i.e. cut-off date and which have been included in the debtors; check that the goods should have been dispatched and not lying with the Company;
- Ensure that all goods dispatched prior to the period/ year-end have been invoiced and included in debtors on a test check basis;
- Ensure that no goods dispatched after the year-end have been invoiced and included in debtors for the period under audit

EXAM NOV 2022

Ques-67 A Ltd. has traded for ₹ 50.00 Lacs in " TETRA " , a virtual currency , during the FY 2021-2022 and earned a profit of 20.00 Lacs on it What disclosure requirements are prescribed for such type of transactions done by the company?

Ans. Disclosure of Crypto Currency or Virtual Currency:

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:

- (a) profit or loss on transactions involving Crypto currency or Virtual Currency
- (b) amount of currency held as at the reporting date,
- (c) deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtual currency.

RTP MAY 2023

Ques-68 While verifying the PPE of the client entity, the auditor also needs to consider whether the PPE has been valued appropriately and as per the generally accepted accounting principles and practices. Explain.

Ans. While verifying the PPE of the client entity, the auditor also needs to consider whether the PPE has been valued appropriately and as per the generally accepted accounting principles and practices. 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.

MTP MARCH 2023, RTP MAY 2023

Ques-69 What are the required disclosures for cash & Cash equivalents to be made by the company as per Schedule III (Part I) to Companies Act, 2013?

Ans. The following are the required disclosures for cash & Cash equivalents to be made by the company as per Schedule III (Part I) to Companies Act, 2013:

Cash and cash equivalents

(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.

MTP MARCH 2023

Ques-70 Studymate Limited is a company engaged in the manufacture of stationery items. The company sells its goods on credit. The debtors as on 31.03.2022, amounted to ₹ 10 crores. What is the disclosure requirement for the company with respect to the ageing schedule of the trade receivables in terms of Schedule III (Part I) to the Companies Act, 2013?

Ans. The following is the disclosure requirement for Studymate Limited with respect to the ageing schedule of the trade receivables in terms of Schedule III (Part I) to the Companies Act, 2013

Trade Receivables ageing schedule

Particulars	(Amount in `)					Total
	Outstanding for following periods from due date of payment#					
	Less than 6 months	6 months- 1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade receivables - considered good						
(ii) Undisputed Trade Receivable-considered doubtful						
(iii) Disputed Trade Receivables considered good						
(iv) Disputed Trade Receivables considered doubtful						

MTP MARCH 2023

Ques-71. While verifying the legal and professional expenses of the client company, what audit procedures should the auditor perform?

Ans, while verifying the legal and professional expenses of the client company, the auditor should perform the following audit procedures

- Obtain a month-wise and consultant-wise summary.

In case of monthly retainership agreements, verify whether the expenditure for all 12 months has been recorded correctly.

For non- recurring expenses, select a sample and vouch for the attributes discussed above.

The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.

MTP MARCH 2023

Ques-72. Name the assertion that the auditor will check by performing the following audit procedures.

- Employees benefit expense in respect of all personnel have been fully accounted for.
- Discounts on sales has been properly adjusted/ accounted for.
- Employee benefit expense recorded during the period relates to the current accounting period only

Ans.

- Completeness
- Measurement
- Cut Off

MTP APRIL 2023

Ques-73 Mayank Ltd. Is covered u/s 135 of the Companies Act,2013 i.e. Corporate Social Responsibility (CSR) What matters shall be disclosed by the company with regard to CSR activities done by the company ?

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

- amount required to be spent by the company during the year,

- (ii) amount of expenditure incurred,
- (iii) shortfall at the end of the year,
- (iv) total of previous years shortfall,
- (v) reason for shortfall,
- (vi) nature of CSR activities,
- (vii) 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,
- (viii) 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

MTP APRIL 2023

Ques-74 CA Mehta is the statutory auditor of ABC 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.

Ans: 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 Mehta, the statutory auditor of ABC 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 personnel.

(ii) For all additions to land, building in particular, CA Mehta, the statutory auditor of ABC 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 immoveable properties held as at the balance sheet date.

(iv) 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, CA Mehta, the statutory auditor of ABC Ltd 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.

(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.

RTP MAY 2023

Ques-75 CA Saurabh is the statutory auditor of UVW Ltd. for the FY 20 -21. While verifying the purchases made by UVW Ltd., CA Saurabh decided to perform analytical procedures to obtain audit evidence regarding the overall reasonableness of purchase quantity and price of purchases. What analysis should CA Saurabh perform?

Ans, CA Saurabh should perform following analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price:

(i) **Consumption Analysis:** He should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from the management if any significant variations are found.

(ii) **Stock Composition Analysis:** He should collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.

(iii) **Ratios:** He should compare the creditors' turnover ratios and stock turnover ratios of the current year with previous years.

He should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.

EXAM MAY 2023

Ques-76 Management of D Ltd. has issued shares at a discount to its creditors. Explain the provisions of the Companies Act, 2013 when shares are issued at a discount to creditors? As an auditor what will be your concern of checking in such a case?

Ans: 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-section (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.

Concern of Checking as an Auditor : The auditor should verify that whether the 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.

EXAM MAY 2023

Ques-77. X Ltd is a hardware manufacturing company. At each and every stage of production processes large amount of scrap is generated in the factory and subsequently sold. As an auditor how will you vouch verify the sale of scrap?

Ans: Vouching/Verification of the Sale of Scrap by Auditor would be undertaken as under:

- (i) Review the internal control as regards generation, storage and disposal of scrap.
- (ii) Check whether the organization is maintaining reasonable record for generation of scrap.
- (iii) Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
- (iv) Check the rates at which scrap has been sold and compare the rate with previous year.
- (v) Vouch sales with invoices raised, advertisement for tender, rate contract with scrap dealers.
- (vi) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
- (vii) Make an overall assessment of the value of realization from scrap as to its reasonableness.

EXAM MAY 2023

Ques-78. CA Q, the auditor of XYZ Ltd, while conducting audit observes that the company has made various provisions in the books of account. What are the audit procedures that CA Q will follow to verify the existence, completeness, and valuation of the provisions made?

Ans: Audit Procedures that CA Q will follow to verify the existence, completeness, and valuation of provisions made are given hereunder:

Existence

1. Obtain a list of all provisions and compare them with balances in the ledger.
2. Inspect the underlying agreements like agreements with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.

Valuation

3. Wherever required, obtain the expert's report, calculation and underlying working for the provision amount. For example - for warranty involving complex calculations, some entities get that valued through an actuary. In such a case, the auditor may request the management to share the actuarial valuation report and in case of any matter under legal dispute, the auditor should request for assessment made by a legal expert in relation to likelihood of a liability devolving on the entity i.e. whether probable or possible or remote as defined above. The

auditor should then verify the underlying assumptions used by the expert with the data shared by the management.

Completeness

4. Obtain the underlying working and the basis for each of the provisions made from the management and verify whether the same is complete and accurate.
5. The auditor shall obtain a written representation from the management that it has made all the provisions which were required to be made as per the recognized accounting principles.

RTP NOV 2023

Ques-79 Internally generated Goodwill can be recognized as an asset

Ans: As per AS-26, internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

RTP NOV 2023

Ques-80 An unexpected decrease in GP Ratio may result due to fictitious sales.

Ans: A fictitious sale will increase the GP Ratio, instead of decreasing it. GP ratio normally comes down if there are unrecorded sales or reversal of fictitious sale entries recorded in the previous year or fictitious purchase or decrease in closing stock.

RTP NOV 2023

Ques-81 M/s MP & Co. Chartered Accountants, have been appointed as auditors of LMP Private Limited The partner of the firm asked the Audit assistant to carry out the 'examination-in- depth of the payment made to a creditor Advise him about the documents to be verified.

Ans: **Examination - in depth of the payment made to creditor:** The Audit Assistant of M/s MP & Co., should verify the following documents of LMP Private Limited in case of payment to a creditor is to be verified "in depth":

- (i) The invoice and statement of account received from the supplier.
- (ii) The entry in the inventory record showing that the goods were received.
- (iii) The Goods Received Note and Inspection Certificate showing that the goods on receipt were verified and inspected.
- (iv) The copy of the original order and authority showing that the goods in fact were ordered by an authority which was competent to do so.

RTP NOV 2023

Ques-82 As an auditor, how will you verify the hire purchase transaction in the case of an entity engaged in the business of hire purchase?

Ans: Verification of Hire-purchase transactions: While checking the hire-purchase transaction, the auditor may examine the following:

1. Hire purchase agreement is in writing and is signed by all parties.
2. Hire purchase agreement specifies clearly -
 - (i) The hire-purchase price of the goods to which the agreement relates;
 - (ii) The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;
 - (iii) The date on which the agreement shall be deemed to have commenced;
 - (iv) The number of instalments by which the hire-purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable; and
 - (v) The goods to which the agreement relates, in a manner sufficient to identify them.
3. Ensure that payments are being received regularly as per the agreement

PYQ NOV 2023

Ques-83 Narrate the audit procedures to be performed by an auditor in order to ascertain that the Raw materials and consumables are valued appropriately and as per generally accepted accounting policies and practices.

PYQ NOV 2023

Ques-84 How is "Short Term Borrowings" disclosed in the Financial Statements as required under Part 1 of Schedule III to the Companies Act, 2013

PYQ NOV 2023

Ques-85 Mention any three expenses which are revenue in nature but qualify as capital expenditure

Chapter-6

Auditors Report

STUDY MATERIAL NEW

Ques-1 "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." Explain

Ans. 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) Whether sufficient appropriate audit evidence has been obtained;
- (b) Whether uncorrected misstatements are material, individually or in aggregate;
- (c) The evaluations.

STUDY MATERIAL NEW

Ques-2 "The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements." Discuss stating clearly qualitative aspects of the entity's accounting practices

Ans. Evaluations by the Auditor

The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements.

Qualitative Aspects of the Entity's Accounting Practices

1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:

- (i) The selective correction of misstatements brought to management's attention during the audit.
- (ii) Possible management bias in the making of accounting estimates.

STUDY MATERIAL NEW

Ques-3 Discuss the factors affecting the decision of the auditor regarding which type of modified opinion is appropriate.

Ans. The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Nature of Matter Giving Rise to the Modification	Auditor's Judgments about the Pervasiveness of the Effects or Possible Effects on the Financial Statements
--	--

	Material but not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

STUDY MATERIAL NEW

Ques-4 Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report".

Ans. As per Standard on Auditing (SA) 705 "Modifications To The Opinion In The Independent Auditor's Report", the objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

STUDY MATERIAL NEW / RTP MAY 20, MAY 23

Ques-5 In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Explain and analyse the indicators of lack of neutrality with examples, wherever required.

Ans. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements.

The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:

- (i) The selective correction of misstatements brought to management's attention during the audit.

Example

- Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
- The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgement and involvement of audit executives.
- (ii) Possible management bias in the making of accounting estimates.

STUDY MATERIAL NEW / RTP MAY 20

Ques-6 The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section.

Ans. 6. The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

The Opinion section of the auditor's report shall also:

- (a) Identify the entity whose financial statements have been audited;
- (b) State that the financial statements have been audited;
- (c) Identify the title of each statement comprising the financial statements;

- (d) Refer to the notes, including the summary of significant accounting policies; and
 (e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

STUDY MATERIAL NEW / EXAM MAY 18 / RTP NOV 20

Ques-7 Define Emphasis of Matter Paragraph and how it should be disclosed in the Independent Auditor's Report?
 Ans. **Emphasis of Matter paragraph:** A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (i) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
 (ii) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
 (iii) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

STUDY MATERIAL NEW / EXAM NOV 18 / MTP APRIL 21, OCT 21, MARCH 23

Ques-8 "An auditor is required to make specific evaluations while forming an opinion in an audit report." State those evaluations.

Ans. **Specific Evaluations by the auditor:** In particular, the auditor shall evaluate whether :

- (i) The financial statements adequately disclose the significant accounting policies selected and applied;
 (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
 (iii) The accounting estimates made by management are reasonable;
 (iv) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
 (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
 (vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

STUDY MATERIAL NEW / MTP APRIL 2023

Ques-9 The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain

Ans. 9. **Responsibilities for the Financial Statements:** The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal

control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and

- (b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

STUDY MATERIAL NEW / RTP NOV 19

Ques-10 Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather Communicating key audit matters in the auditor's report is in the context of the Auditor having formed an opinion on the financial statements as a whole. Analyse.

Ans. **Communicating key audit matters in the auditor's report is not:**

- (i) A substitute for disclosures in the financial statements that the applicable Financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (ii) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
- (iii) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (iv) A separate opinion on individual matters

STUDY MATERIAL NEW / RTP NOV 19, RTP NOV 20

Ques-11 The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion". Explain what is included in this "Basis for Opinion" section.

Ans. 11. Basis for Opinion: The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- (a) States that the audit was conducted in accordance with Standards on Auditing;
- (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

STUDY MATERIAL NEW

Ques-12 Distinguish between an adverse opinion and a qualified opinion. Also draft an opinion paragraph for both types of opinion.

Ans. 12. An auditor shall express an adverse opinion, when the auditor having obtained sufficient and appropriate audit evidence, concludes that misstatements, individually or in aggregate are both material and pervasive.

Whereas, when the auditor, having obtained sufficient and appropriate audit evidence, concludes that misstatements are material but not pervasive, shall express a qualified opinion.

SA705 - "Modifications To The Opinion In The Independent Auditor's Report" deals with the form and content of both types of report. The following are the draft of the opinion paragraphs of the reports.

(a) Adverse Opinion

We have audited the accompanying consolidated financial statements of ABC Company Limited (hereinafter referred to as the "Holding Company") and its subsidiaries (the Holding Company and its subsidiaries together referred to as "the Group"), its associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2021, the consolidated statement of profit and Loss, (consolidated statement of changes in equity) and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the

"consolidated financial statements"). In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2021, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

(b) Qualified Opinion

We have audited the standalone financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 2021, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)). In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31st, 2021 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

STUDY MATERIAL NEW

Ques-13 ABC Ltd is a company incorporated in India. It has branches within and outside India. Explain who can be appointed as an auditor of these branches within and outside India. Also explain to whom branch auditor is required to report.

Ans. Sub-section (8) of section 143 of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

STUDY MATERIAL NEW

Ques-14 Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard.

Ans. 14. Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:

- (a) identify division of audit areas and common audit areas;
- (b) ascertain the reporting objectives of the engagement;
- (c) consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;
- (d) consider the results of preliminary engagement activities, or similar engagements performed earlier;
- (e) ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

STUDY MATERIAL NEW

Ques-15 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.

Ans. 15. 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:

- (i) Sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower workload.
- (iv) Better quality of performance.
- (v) Improved service to the client.
- (vi) 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.
- (vii) Lower staff development costs.
- (viii) Lower costs to carry out the work.
- (ix) A sense of healthy competition towards a better performance

STUDY MATERIAL NEW

Ques-16 Discuss the reporting requirements under CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares.

Ans. 16. The following are the disclosure requirements as per CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares.

- (a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
- (b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of noncompliance;

STUDY MATERIAL NEW

Ques-17 Discuss which class of companies are specifically exempt from the applicability of CARO 2020?

Ans. 17. CARO 2020 shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013, except-

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- (ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company as defined in clause (62) of section 2 of the Companies Act and a small company as defined in clause (85) of section 2 of the Companies Act; and
- (v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act

(including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

STUDY MATERIAL OLD

Ques-18 Give a brief description about the management responsibility to be mentioned in the statutory auditor's report.

Ans. The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted.

Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

RTP MAY 19 / PYQ NOV 2023

Ques-19. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. Explain clearly stating the essential audit reporting differences between the approaches. Also define comparative information and audit procedures regarding comparative information.

Ans. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

The essential audit reporting differences between the approaches are:

- (a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas
- (b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

Definition of Comparative information – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

Audit Procedures regarding comparative information

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, **the auditor shall evaluate whether:**

- (a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and

(b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

RTP MAY 19

Ques-20. Define Emphasis of Matter paragraph. When the auditor shall include an Emphasis of Matter paragraph in the auditor's report? Also explain how the auditor would include an Emphasis of Matter in the auditor's report?

Ans. **Emphasis of Matter paragraph** - A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Emphasis of Matter Paragraphs in the Auditor's Report

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements,

the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

Separate section for Emphasis of Matter paragraph

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
- (c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

EXAM NOV 19

Ques-21. When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures. Discuss the exception of the above statement when prior period financial statements are audited

Ans. When corresponding figures are presented, the auditor's opinion shall not refer to the

Corresponding figures except in the following circumstance.

1. If 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 matter which gave rise to the modification is unresolved, the auditor shall modify auditor's report opinion on the current period's financial statements. In the basis for modification paragraph in the auditor's report the auditor shall either:

(i) 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 figure are material; or

(ii) 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.

Ques-22. The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain.

Ans. Responsibilities for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (i) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
- (ii) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

MTP OCTOBER 20

Ques-23. State clearly the objective of the Auditor as per SA 706. Also define emphasis of matter paragraph and other matter paragraph.

Ans. As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

- (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
- (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Emphasis of Matter paragraph - A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Other Matter paragraph - A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

MTP MAY 20, RTP MAY 21

Ques-24. The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. Discuss the type of opinion that can be given and state giving reasoning.

Ans. Unqualified Opinion:

1. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.
2. An unqualified opinion indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.
3. An unqualified opinion also indicates that:
 - (i) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;
 - (ii) the financial statements comply with relevant statutory requirements and regulations; and
 - (iii) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

EXAM NOV 20, RTP NOV 21

Ques-25. How would an auditor determine key Audit Matters as per SA - 701 "Communicating Key Audit Matters in the Independent Auditors Report"?

Ans. 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:

- (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA315.
- (b) 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.
- (c) 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 stated para were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters

EXAM JAN 21

Ques-26. What an auditor should state in "Basis for opinion" section of auditor's report and when the auditor modifies the opinion on the financial statements, what amendments he should make in this section?

Ans. An auditor should state in "Basis for Opinion" section of Auditor's Report as under: Basis for Opinion:

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- (i) States that the audit was conducted in accordance with Standards on Auditing;
- (ii) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (iii) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (iv) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Amendments an Auditor should make :

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (i) Amend the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
- (ii) Within this section, include a description of the matter giving rise to the modification.

RTP MAY 21

Ques-27. The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally. Explain

Ans. The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users. This SA promotes consistency in the auditor's report but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions. Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

RTP NOV 21

Ques-28. As an auditor of listed company, what are the matters that the auditor should keep in mind while determining "Key Audit Matters".

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

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

The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

EXAM JULY 21

Ques-29. CA Guru is in the process of preparing the final audit report of JPA Private Limited and would like to disclaim his opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence. How CA Guru shall amend the description of the auditor's responsibilities as required by SA 700 (Revised)?

Ans. Since the auditor, CA Guru, disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence of JPA Pvt Ltd, the auditor (CA Guru) shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient 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)

MTP NOV 21

Ques-30. Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph.

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

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

MTP MARCH 2022

Ques-31. While conducting audit of VED Ltd., you as an auditor are not only prevented in completing certain audit procedures but also are not able to obtain audit evidence even by performing alternative procedures. How you will deal with this situation?

Ans. As per SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (1) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (2) 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 the auditor withdraws, before withdrawing, the 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.

MTP APRIL 2022

Ques-32. Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not considered as a substitute or alternative for a number of important items. What are those items?

Ans. As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (i) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (ii) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report";
- (iii) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (iv) A separate opinion on individual matters.

MTP SEPT 2022

Ques-33 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.

Ans: 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.

RTP MAY 2022

Ques-34. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. Explain stating clearly specific evaluations made by the auditor.

Ans. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements.

In particular, the auditor shall evaluate whether:

- (a) The financial statements adequately disclose the significant accounting policies selected and applied;
- (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (c) The accounting estimates made by management are reasonable;
- (d) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- (e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (f) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Further, when the financial statements are prepared in accordance with a fair presentation framework, the evaluation mentioned above shall also include an evaluation by the auditor as to whether the financial statements achieve fair presentation which shall include consideration of:

- (a) The overall presentation, structure and content of the financial statements; and
- (b) Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

RTP MAY 2022

Ques-35. 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

Ans. 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).

EXAM MAY 2022

Ques-36. D Ltd. is a company engaged in publishing business magazines. CA P is the statutory auditor of the company. The company takes property in the barter deal from its real estate customers against publication of their advertisements. The properties obtained during the year through such barter deals have been considered in the books of accounts on the basis of possession letter only and have been included in PPE in the financial statements. Considering this matter of such importance that is fundamental to the users understanding, CA P has decided to communicate the same in his report. CA P seeks your guidance in reporting this matter in his audit report.

Ans. Emphasis of Matter Paragraphs in the Auditor's Report: If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- (i) The auditor would not be required to modify the opinion in accordance with SA 705 as a result of the matter; and
- (ii) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

In the given case as the properties obtained during the year through barter deals and included in the PPE in the books of accounts on the basis of possession letter only, hence there is a need to add Emphasis on Matter Paragraph in the Auditor's Report.

The draft of the same is as under:

Emphasis of Matter - Effect of Properties obtained through barter deals by the company
We draw attention to Note (Y) of the financial statements, which describes the effects of the properties obtained through barter by the company. Our opinion is not modified in respect of this matter.

Alternative Solution:

In the given case as the properties obtained during the year through barter deals and included in the PPE in the books of accounts on the basis of possession letter only, hence there is a need to report the same under Clause i(c) of Paragraph 3 Companies (Auditor's Report) Order, 2020.

Matters to be included in auditor's report - The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matter, namely:

- (i) (c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held- indicate range, where appropriate	Reason for not being held in name of company* *also indicate if in dispute
1	2	3	4	5	6

The auditor should state in the Reason (column 6) for not being held in name of company as follows
"Properties obtained during the year through barter deals and included in the PPE in the books of accounts on the basis of possession letter only"

Ques-37. 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?

Ans. 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. If 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 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.

EXAM NOV 2022

Ques-38. NG Ltd. appointed CA N as the statutory auditor for the F.Y. 2021-2022. Previous year's auditor gave a qualified opinion on the Comparative Financial Statements for the year ended 31.03.2021. What will be the reporting responsibility casted on CAN when he forms an opinion and prepares audit report on the Comparative Financial Statements for the F.Y. 2021-2022?

Ans. Prior Period Financial Statements Audited by a Predecessor Auditor: As per SA 710, 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, CA. N, the auditor of NG Limited shall state in an Other Matter paragraph:

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

RTP MAY 2023

Ques-39. The description of management's responsibilities in the auditor's report includes reference to management's responsibilities as it helps to explain to users the premise on which an audit is conducted. Explain

Ans. Responsibilities of Management for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial

statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
- (b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

EXAM MAY 2023

Ques-40. Elucidate the circumstances when a modification to the Auditor's opinion is required. Also state the factors for making the decision regarding which type of modified opinion is appropriate.

Ans: Circumstances When a Modification to the Auditor's Opinion Is Required

The auditor shall modify the opinion in the auditor's report in the following circumstances:

1. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
2. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

RTP NOV 2023

Ques-41 The inclusion of an Emphasis of Matter paragraph in the Auditor's Report affects the auditor's opinion.

Ans: When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall indicate that the auditor's opinion is not modified in respect of the matter emphasized. Such a paragraph shall refer only to information presented or disclosed in the financial statements. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion.

RTP NOV 2023

Ques-42 Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not considered as a substitute or alternative for a number of important items. What are those items?

Ans: As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (i) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;

- (ii) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report";
- (iii) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (iv) A separate opinion on individual matters.

RTP NOV 2023

Ques-43 What an auditor should state in the "Basis for opinion" section of auditor's report ? When the auditor modifies the opinion on the financial statements, explain the amendments he should make in this section?

Ans: An auditor should state in "Basis for Opinion" section of Auditor's Report as under:

Basis for Opinion:

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- (i) States that the audit was conducted in accordance with Standards on Auditing;
- (ii) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (iii) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (iv) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Amendments an Auditor should make:

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (i) Amend the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
- (ii) Within this section, include a description of the matter giving rise to the modification.

PYQ NOV 2023

Ques-44 M/s ABC & Associates, statutory auditors of Opaque Ltd., are in the process of finalizing the audit report of the company but in view of their inability to obtain sufficient appropriate audit evidence, they would like to disclaim their opinion on the financial statements. Explain reporting responsibilities of M/s ABC & Associates pursuant to SA 700 (Revised). How they will address key audit matters section in accordance with SA 701 when they are expressing disclaimer of an opinion on the financial statements ?

PYQ NOV 2023

Ques-45 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, explain the areas of concern that an auditor should take into account.

Chapter - 7 CARO, 2020

EXAM MAY 18

Ques-1. State the matters to be included in the auditor's report as per CARO, 2020 regarding

- (1) Private placement of preferential issue.
- (2) Utilizations of IPO and further public offer.

Ans. (i) The auditor is required to report as per clause xiv of paragraph 3 of CARO 2016, whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(ii) It is duty of the auditor to report as per clause ix of paragraph 3 of CARO 2016, whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

EXAM MAY 18

Ques-2. State the matters to be included in the auditor's report as per CARO, 2020 regarding

- (1) Property Plant and Equipment
- (ii) Statutory dues Or Explain the Reporting requirements the auditor should ensure under CARO, 2020 related to Property Plant and Equipment.

Ans. (i) The auditor is required to report as per clause xiv of paragraph 3 of CARO 2020, whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(ii) It is duty of the auditor to report as per clause ix of paragraph 3 of CARO 2020, whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

RTP MAY 20

Ques-3. The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹ 50 lakh and cleared all the payments to such bogus creditor. How will you deal as an auditor?

Ans. Here, the auditor of the company is required to report the fraudulent activity to the Board or Audit Committee (as the case may be) within 2 days of his knowledge of fraud. Further, the company is also required to disclose the same in Board's Report. It may be noted that the auditor need not to report the central government as the amount of fraud involved is less than ₹ 1 crore, however, reporting under CARO, 2016 is required.

MTP MAY 20

Ques-4. (a) State the matters to be included in the auditor's report as per CARO, 2016, regarding:

- (i) Fixed Assets
- (ii) Statutory Dues.

Ans. Matters to be included in the Auditor's Report under CARO, 2016: The auditor's report on the accounts of a company to which CARO applies shall include a statement on the following matters, namely-

- (i) Fixed Assets-

(1) Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(2) Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account; (3) Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.

(ii) As per clause (vii) of CARO, 2016, reporting requirements in respect of statutory dues are:

(1) whether the company is regular in depositing undisputed statutory dues including 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;

(2) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax 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).

MTP MARCH 21, EXAM NOV 19

Ques-5. M Ltd. has given certain loans to related parties and also has accepted certain deposits. As an auditor, how will you include the above items in paragraph 3 of CARO, 2020?

Ans. 1. Clause (iii) of paragraph 3 of CARO, 2020 states

Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(i) Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(ii) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(iii) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

2. Further, Clause (v) of paragraph 3 of CARO, 2020 states in case the company has accepted deposits,

(i) Whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions is stated;

(ii) If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

In the given situation, M Ltd. has given certain loans to related parties and also has accepted certain deposits. Thus, the auditor is required to report the same as per clause (iii) and (v) of Paragraph 3 of CARO, 2020.

MTP APRIL 21

Ques-6. (a) State the matters to be included in auditor's report as per CARO, 2016 regarding:

(i) Default in repayment of loan or borrowing to a financial institution, bank etc.

(ii) Fraud by the company or on the company by its officers or employees.

Ans. **Matters to be included in Auditor's report as per CARO 2016:**

(i) Clause (viii) of Para 3 of CARO, 2016, requires the auditor to report whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

(ii) Clause (x) of Para 3 of CARO, 2016, requires the auditor to report whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

MTP APRIL 21

Ques-7. Provision of CARO, 2016 is not applicable to ABC Pvt. Ltd., a subsidiary of XYZ Ltd. (a public company) having fully paid up Capital and Reserves & Surplus of Rs. 50 lakhs, Secured loan from bank of Rs. 90 Lakhs and Turnover of Rs. 5 Crore, for the financial year 2018-19.

Ans. The CARO specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees 1 crore as on the balance sheet date and which does not have total borrowings exceeding rupees 1 crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees 10 crore during the financial year as per the financial statements.

From the above, it is clear that ABC Pvt. Ltd. is a subsidiary of XYZ Ltd. and hence not exempt from CARO, 2016 although it is satisfying the conditions that allow exemption to private limited company which is not a subsidiary or holding company of a public company.

MTP OCTOBER 21, EXAM NOV 18

Ques-8. The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long term loans and advances." Advise the auditor regarding reporting requirements under CARO, 2016.

Ans. The auditor is required to report as per clause xiv of paragraph 3 of CARO 2016, whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

In view of the above clause, the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose rather the company has utilised these funds for repayment of long term loans and advance.

MTP NOV 21

Ques-9. State the matters to be included in auditor's report as per CARO, 2016 regarding:

- (i) Default in repayment of loan or borrowing to a financial institution, bank etc.
- (ii) Fraud by the company or on the company by its officers or employees.

Ans. **Matters to be included in Auditor's report as per CARO 2016:**

(i) Clause (viii) of Para 3 of CARO, 2016, requires the auditor to report whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

(ii) Clause (x) of Para 3 of CARO, 2016, requires the auditor to report whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

RTP NOV 21

Ques-10. Explain the Reporting requirements the auditor should ensure under CARO 2016 related to fixed assets.

Ans. Reporting for Fixed Assets- Clause (i) of Para 3 of CARO, 2016, requires the auditor to include a statement in the auditor's report on the following matters, namely-

- (i) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;
- (ii) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (iii) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

MTP APRIL 21

Ques-11. 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?

Ans. 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

EXAM DEC 21

Ques-12. State the auditor's reporting responsibilities under CARO 2016 when-

- (i) The company has raised money by public issue
- (ii) The company has made private placement of shares

Ans. Auditor's reporting responsibilities under CARO 2016:

- (i) Clause (ix) para 3 of CARO, 2016 states - whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.
- (ii) Clause (xiv) para 3 of CARO, 2016 states - whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance.

MTP MARCH 2022

Ques-13. 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.

Ans. 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 funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated;
- (e) 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;
- (f) 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;

MTP APRIL 22

Ques-14. 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.

Ans. 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:-

- (a) Details of such property, including year of acquisition,
- (b) Amount thereof,
- (c) Details of Beneficiaries,
- (d) If property is in the books, then reference to the item in the Balance Sheet,
- (e) If property is not in the books, then the fact shall be stated with reasons,
- (f) Where there are proceedings against the company under this law as an abetter of the transaction or as the transferor then the details shall be provided,
- (g) Nature of proceedings, status of same and company's view on same.

MTP APRIL 22

Ques-15. State the matters to be included in auditor's report as per CARO, 2020 regarding - Verification of inventory and working capital limits

Ans. Matters to be included in Auditor's report as per CARO 2020:

- (i) 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;

RTP MAY 22

Ques-16. Explain the Reporting requirements the auditor should ensure under CARO 2020 related to PPE and Intangible assets..

Ans. Reporting for PPE and Intangible assets - Clause (i) of Para 3 of CARO ,2020, requires the auditor to include a statement in the auditor's report on the following matters, namely -

- (i) (a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;
- (B) whether the company is maintaining proper records showing full particulars of intangible assets;
- (b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held -indicate range, where appropriate	Reason for not being held in name of company*
					*also indicate if in dispute

- (d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;
- (e) Whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

EXAM MAY 22

Ques-17. Q. G Pvt . Ltd. had fully paid up Capital and Reserves of 1.20 crore is at the end of F.Y 2020-2021. During the F.Y 2021-2022 , business was interrupted due to Covid restrictions and therefore the company incurred losses to the tune of 25 lacs . During the year, the company also borrowed 55 lakh each from a bank and a financial institution independently. It had a turnover of 850 lakh (other than revenue of 250 lakh from discontinuing operations) . Ascertain whether CARO , 2020 is applicable to the company .

Ans. **Applicability of CARO, 2020 in case of Private Ltd. Company:**

CARO, 2020 shall apply to every company including a foreign company except- a private limited company, not being a subsidiary or holding company of a public company,

- (i) having a paid-up capital and reserves and surplus not more than one crore rupees as on the balance sheet date; and
- (ii) which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year; and
- (iii) which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

Applying the above to the given case, G Pvt. Ltd., its paid-up capital and reserves are ` 95 Lakh (` 120 Lakh - ` 25 Lakh), borrowings from a Bank and financial institution are (` 55 Lakh + ` 55 Lakh) i.e., ` 1.10 Crore, turnover {including discontinuing operations (` 850 lakh + ` 250 Lakh)} ` 1100 Lakh i.e., ` 11 Crore.

Since its borrowings and turnover are exceeding the specified limit and therefore it is not exempt from the applicability of CARO, 2020.

EXAM NOV 22

Ques-18. TS Ltd. has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long-term loans and advances. What are the reporting requirements under CARO 2020 in this case?

Ans. Reporting Requirements under CARO 2020 for raising funds: As per clause (x)(b) of Para 3 of CARO, 2020, the auditor of a company has to report whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance.

In the present case, TS Ltd. has raised funds by issuing fully convertible debentures for expansion and diversification of the business. However, the company used the funds for repayment of long-term loans and advances instead of utilisation of the same for the purpose for which the funds were raised i.e. expansion and diversification of business.

Here, the auditor should report the fact in his report that the funds were used for the purpose other than the purpose for which the funds were raised, as per clause (x)(b) of Para 3 of CARO, 2020.

MTP MARCH 2023

Ques-19. Discuss the reporting requirements as per CARO, 2020, regarding:

- (i) disputed and undisputed statutory dues and
- (ii) internal audit system of the company

Ans. **Undisputed and Disputed 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 system 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.

EXAM MAY 2023

Ques-20. ABC Ltd. is a public company, which has availed various loans and cash credit facilities from Banks and other financial institutions. The company has defaulted repayments of such borrowings during the year under audit. What are the reporting requirements in this regard under the Companies (Auditor's Report) Order, 2020?

Ans: As per Clause (ix) of CARO, 2020, reporting requirements in case of default by the company in repayments of borrowings would be:

(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 funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;

PYQ NOV 2023
<p>Ques-21 UVW Ltd. A biopharma company and global manufacturers of select critical care medical products, has been sanctioned working capital limits Rs 5.99 crores from a nationalized bank on the basis of security of current assets. During the year under audit, the statutory auditor of UVW Ltd. Considers that inventory is material to the financial statements and performs audit procedures over the company's final inventory records to determine whether they accurately reflect actual inventory. What are the reporting requirements under CARO 2020 in this case?</p>

Chapter - 8

Special Features of Audit of Different types of Entities

STUDY MATERIAL NEW

Ques-1 Discuss, in what circumstances, Central Registrar can hold an inquiry into working and financial condition of a multi-state cooperative society.

Ans. The Central Registrar may, on a request from a federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or not less than one-third of the members of the board or not less than one-fifth of the total number of members of a Multi-state co-operative society, hold an inquiry or direct some person authorized by him by order in writing in his behalf to hold an inquiry into the constitutions, working and financial condition of a Multi-State Co-operative society. However, before holding such inquiry fifteen days notice must be given to the Multi-State co-operative society.

STUDY MATERIAL NEW

Ques-2 Sporting Club of India is a private club engaged in promotion of sports in the country. As an auditor of this leading club, discuss any two points to ensure that expenditure incurred by club during the year is properly authorised.

Ans.

1. Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the Managing Committee has benefited there from either directly or indirectly.
2. Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test-basis.
3. Verifying the cash and bank payments.
4. Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

STUDY MATERIAL NEW / EXAM JULY 21

Ques-3 Tomo Construction Engineering LLP approached CA K to understand various returns to be filed by them as part of statutory compliance. Discuss, how, CA K should advise them.

Ans. **Returns to be maintained and filed by an LLP:**

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

STUDY MATERIAL NEW

Ques-4 A multi-speciality hospital has come up in your city. You are appointed as auditor for first year. Discuss, any four, broad areas to be kept in mind while conducting audit of accounts of such a newly opened multi-speciality hospital.

OR

Explain in detail the duties of Comptroller and Auditor General of India

Ans:

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

3. **Income from Investments, Rent etc:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
4. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
5. **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
6. **Grants:** - Verify that grants, if any, received from Government or local authority has been duly accounted for.
7. **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.
8. **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
9. **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
10. **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
11. **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
12. **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

STUDY MATERIAL NEW

Ques-5 Mention the special points to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the Chartered Accountancy Course and which charges only INR 500 per month from a student for their lodging/boarding.

Ans. **Verification of expenses**

- (i) Check the day-to-day administration expenses incurred along with the necessary vouchers, supporting for the same like salary registers, repairs register, etc.
- (ii) Verify whether the expenses incurred are in conformity with the budgets prepared internally or filed with the relevant authorities.
- (iii) Check the amount spent on provisions of hostel facilities with reference to bills, etc.
- (iv) See that whenever heavy expenditure has been incurred on renovation of the hostel, computer centre, etc. the same is accounted for properly (if such facilities are being provided by the hostel).
4. Verify investments made from surplus funds as well as existing investments by physically verifying the same and that they are in the name of the institution and that there is no charge/pledge against the same.
5. Verify all capital expenditure and expenditure on repairs, etc., incurred with the vouchers and also whether proper tenders, etc., were invited for the same. See that all furniture, glass, cutlery, kitchen utensils, linen, etc. are adequately depreciated.
6. **Library Facilities:** See that proper library register are maintained. The system regarding issue and receipt of books is in order. Late fee fines and money received on account of lost book is accounted for properly. Obsolete books are written off only after proper authorisation. Expenses incurred on newspapers and weekly magazines as compared to Journals and periodicals have been accounted for properly.
7. Check the provision of other additional facilities like computer facilities, etc. Ensure that proper registers are maintained for charging fees, based on monthly or hourly basis. In case such facility is extended to each room, whether the charges are payable on lump-sum basis or on actual usage basis. Also ensure that amounts spent have been allocated properly.
8. Verify whether the institution is eligible for income tax exemption and if not, whether provision for taxation has been made.

STUDY MATERIAL NEW

Ques-6 An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.

Ans. Receipt of Donations:

- (i) **Internal Control System:** Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (ii) **Custody of Receipt Books:** Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
- (iii) **Receipt of Cheques:** Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
- (iv) **Bank Reconciliation:** Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (v) **Cash Receipts:** Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (vi) **Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of Donations to Different NGOs:

- (i) **Mode of Sending Remittance:** All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinized thoroughly with reference to recipient.
- (ii) **Confirming Receipt of Remittance:** All remittances are supported by receipts and acknowledgements.
- (iii) **Identity:** Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.
- (v) **Donation Utilizations:** utilizations of donations for providing relief to Tsunami victims and not for any other purpose.
- (vi) **System of NGOs' Selection:** System for selecting NGO to whom donations have been sent.

STUDY MATERIAL NEW / MTP APRIL 2023

Ques-7 As an auditor, what would be your areas of consideration while auditing the element of ROOM SALES during the audit of a 5-Star Hotel.

Ans. Following points merit consideration while auditing the element of ROOM SALES during the audit of a Hotel :-

- (a) The charge for room sales is normally posted to guest bills by the receptionist/ front office or in the case of large hotels by the night auditor.
- (b) The source of these entries is the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.
- (c) Any difference between the charged rates used on the guests' bills and the standard room rate should be investigated to ensure that they have been properly authorized.
- (d) In many hotels, the housekeeper prepares a daily report of the rooms which were occupied the previous night and the number of beds kept in each room. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.
- (e) Ensure compliance with the provisions of FEMA and RBI if receipts are in foreign currency, Ensure application of proper Conversion rate.

- (f) Special emphasis to be laid on receipts through Credit Cards.
 (g) The auditor should ensure that proper valuation of occupancy-in- progress at the balance sheet date is made and included in the accounts.

STUDY MATERIAL NEW

Ques-8 You are auditing the Books of accounts of Karla Multiplex which runs 15 Film shows everyday. One of the major issues which are of concern to you as an auditor is the Agreement entered into the Multiplex owners with the Film Distributors. State what points would you check as an auditor in this respect.

Ans. Following points merit consideration while auditing the element of ROOM SALES during the audit of a Hotel :-

- (a) The charge for room sales is normally posted to guest bills by the receptionist/ front office or in the case of large hotels by the night auditor.
 (b) The source of these entries is the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.
 (c) Any difference between the charged rates used on the guests' bills and the standard room rate should be investigated to ensure that they have been properly authorized.
 (d) In many hotels, the housekeeper prepares a daily report of the rooms which were occupied the previous night and the number of beds kept in each room. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.
 (e) Ensure compliance with the provisions of FEMA and RBI if receipts are in foreign currency. Ensure application of proper Conversion rate.
 (f) Special emphasis to be laid on receipts through Credit Cards.
 (g) The auditor should ensure that proper valuation of occupancy-in- progress at the balance sheet date is made and included in the accounts.

STUDY MATERIAL NEW / EXAM DEC 21

Ques-9 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.

Ans. 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.

STUDY MATERIAL NEW / EXAM DEC 21

Ques-10 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.

Ans. 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.

STUDY MATERIAL NEW / EXAM DEC 21

Ques-11 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?

Ans. 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:

- (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.

STUDY MATERIAL NEW

Ques-12 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.

Ans: Subscriptions

1. Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.
2. 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.

Grants

1. Vouching the amount received with the relevant correspondence, receipts and minute books.
2. Obtaining a certificate from a responsible official showing the amount of grants received.

STUDY MATERIAL NEW / MTP MARCH 23

Ques-13 State the points which merit consideration in the audit of a CLUB w.r.t its members.

Ans. The points which merit consideration in the audit of a CLUB w.r.t its members: -

- (1) **Entrance Fee:** - Vouch the receipt on account of entrance fees with -
 - members' applications and counterfoils issued to them,
 - On a reference to minutes of the Managing Committee.
- (2) **Member Subscriptions:** - 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 number of total subscriptions due with the amount collected and that outstanding.
- (3) **Subscription Arrears/in Advance:** - Ensure that -
 - arrears of subscriptions for the previous year have been correctly brought over,
 - Arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
 - Subscriptions received in advance should have been properly accounted for.
- (4) **Arithmetical accuracy:** - Check totals of various columns of the Register of members and tally them across.
- (5) **Register of Members:** - 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) **Member Accounts:** - Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

STUDY MATERIAL NEW, EXAM NOV 19, EXAM JULY 21

Ques-14 The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital?

OR

You have been appointed auditor of M/s. Divine Children Hospital. Discuss any four important points that would attract your attention while audit.

OR

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

Ans. Special points of consideration while auditing certain transactions of a hospital 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 example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
- (iii) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.

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

STUDY MATERIAL NEW / RTP NOV 21

Ques-15 You have been appointed as an auditor of an NGO, briefly state the points on which you would concentrate while planning the audit of such an organisation?

OR

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

Ans. **While planning the audit of an NGO, 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 related to the statutes.
- (iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
- (iv) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
- (v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- (vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- (vii) Setting of materiality levels for audit purposes.
- (viii) The nature and timing of reports or other communications.
- (ix) The involvement of experts and their reports.
- (x) Review the previous year's Audit Report.

STUDY MATERIAL NEW / RTP MAY 21/ EXAM JULY 21

Ques-16 Define Government Audit & explain its objectives

OR

Government audit has not only adopted the basic essentials of auditing as known and practiced 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.

Ans. 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:-

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

STUDY MATERIAL, EXAM MAY 19, MTP APRIL 2023

Ques-17 Central Govt. hold 55% of the paid up share Capital in Kisan Credit Co- operative Society, which is incurring huge losses. Advise when the Central Government can direct Special Audit under Section 77 of the Multi State Co- operative Society Act.

Ans. Central Government shall order for special audit only if that Government or the State Government either by itself or both hold fifty-one percent or more of the paid-up share capital in such Multi -State co-operative society. Under section 77 of the Multi-State Co-operative Societies Act, 2002, where the Central Government is of the opinion:

I. that the affairs of any Multi-State co-operative society are not being managed in accordance with self-help and mutual deed and co- operative principles or prudent commercial practices or with sound business principles; or

Ii that any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains; or

Iii that the financial position of any Multi-State co-operative society is such as to endanger its solvency.

Thus, in the given case since Central Govt is holding 55% shares and financial position of Kisan Credit co- operative society is in danger, Central government can direct for special audit.

RTP MAY 19, EXAM NOV 19

Ques-18 Discuss the matters which should be specially considered in the audit of accounts of a partnership.

OR

There are certain points which are required to consider Especially in the audit of accounts of a partnership. Discuss any three points briefly.

Ans. Matters which should be specially considered in the audit of accounts of a partnership:

(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.

(iii) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(iv) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(v) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements. (vi) Confirming that a provision for the firm's tax payable by the partnership has been made

in the accounts before arriving at the amount of profit divisible among the partners.

(vii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio

EXAM MAY 19

Ques-19 Define the different types of lease agreements as per Accounting Standard/IND-AS.

Ans. AS-19/ Ind-AS 17 defines that lease arrangements could be of 2 types i.e.

(i) Finance Lease and

(ii) Operating Lease.

Finance Lease: An arrangement with the following attributes qualifies as a Finance Lease:

The lease arrangement transfers ownership of the asset to the lessee at the end of the lease term:

- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- the leased assets are of such a specialized nature that only the lessee can use them without major modifications

Operating Lease.
An arrangement that does not transfer substantially all the risks and rewards incidental to ownership qualifies as an Operating Lease. In other words, an operating lease is a lease arrangement "Other than finance lease".

EXAM NOV 18, RTP Nov 19, MTP MARCH 21

Ques-20 Write basis standards set for Expenditure Audit of Government

OR

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.

Ans Government Expenditure Audit: 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. Briefly, these standards are explained below:

(i) Audit against Rules & Orders: The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.

(ii) Audit of Sanctions: The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.

(iii) Audit against Provision of Funds: It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.

(iv) Propriety Audit: It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.

(v) Performance Audit: This involves 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. Efficiency-cum- performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

RTP NOV 19, MTP APRIL 2022

Ques-21 What are the special steps involved in conducting the audit of an Educational Institution?

OR

What are the special steps involved in conducting the audit of an Educational Institution? (Write any 12 points)

Ans. 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.

EXAM NOV 19

Ques-22 In the case of audit of a charitable institution, what attentions should be paid by auditor regarding audit of expenditure items?

Ans. Audit of Expenditure of Charitable Institution:

- (i) Vouching payment of grants also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the management committee has benefited there from either directly or indirectly.
- (ii) Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test basis.
- (iii) Check payment along with supporting documents in regard to salary and other expenses. Verify that all payments are made after proper sanction by appropriate authority.
- (iv) Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.
- (v) Verifying the cash and bank balances/payments.

EXAM MAY 19, MTP MAY 20, MTP NOVEMBER 21, MTP APRIL 2023

Ques-23 Discuss the powers of C&AG in Government Audit

OR

The C&AG Act gives powers to the C&AG in connection with the performance of his duties. Explain.

OR

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.

Ans. Powers of C&AG: The C&AG Act gives the following powers to the C&AG in connection with the performance of his duties-

- i. To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.
- ii. To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
- iii. To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the 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 transactions as he may determine

MTP MAY 20, MTP APRIL 21

Ques-24 Cine screen 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?

Ans. 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.

RTP MAY 20

Ques-25 (a) As per Multi-state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account. Explain

(b) Explain the powers and duties of auditors under the Multi-State Co-operative Societies Act, 2002.

Ans (a) As per sub-section (3) & (4) of section 73 of Multi- state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account, which are laid before the Multi-State co- operative society in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanation given to him, the said account give the information required by this act in the manner so required, and give a true and fair view:

(a) In the case of the balance-sheet, of the state of the Multi-State co-operative society's affairs as at the end of its financial year; and

(b) In the case of the profit and loss account, of the profit or loss for its financial year. The auditor's report shall also state:

(i) Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.

(ii) Whether, in his opinion, proper books of account have been kept by the Multi- State co-operative society so far as appears from his examination of these books and proper returns adequate for the purpose of his audit have been received from branches or offices of the Multi-State co-operative society not visited by him.

(iii) Whether the report on the accounts of any branch office audited by a person other than the Multi-State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

(iv) Whether the Multi-State co-operative society's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and return.

Where any of the matters referred to in sub-section (3) or (4) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

(b) Section 73 of the Multi-State Co-operative Societies Act, 2002 discusses the powers and duties of auditors. According to this, every auditor of a Multi-State co-operative society shall have a right of access at all times to the books accounts and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi- State co-operative society or elsewhere, and shall be entitled to require from the officers or other employees of the Multi- State co-operative society such information and explanation as the auditor may think necessary for the performance of his duties as an auditor.

As per section 73(2), the auditor shall make following inquiries:

(a) Whether loans and advances made by the Multi-State co-operative society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi-State co-operative society or its members,

(b) Whether transactions of the Multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the Multi-State co-operative society,

(c) Whether personal expenses have been charged to revenue account, and

(d) Where it is Stated in the books and papers of the Multi-State co-operative society that any shares have been allotted for cash, whether cash has actually, been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet as correct regular and not misleading.

MTP OCTOBER 20

Ques-26 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.

Ans. 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.

RTP NOV 20, EXAM NOV 20, MTP NOV 21, MTP APRIL 2022

Ques-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

OR

What is the function of audit while examining various rules, regulations and orders with regard Audit against Rules & Orders by C&AG?

Ans. Audit against Rules & Orders - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made there under. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- (a) They are not inconsistent with any provisions of the Constitution or any laws made there under;
- (b) They are consistent with the essential requirements of audit and accounts as determined by the C&AG;
- (c) They do not come in conflict with the orders of, or rules made by, any higher authority; and
- (d) In case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

RTP NOV 20

Ques-28 The auditor of a Govt Company has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority. Explain

Ans. Audit of sanctions - The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority. The audit of sanctions is directed both in respect of ensuring that the expenditure is properly covered by a sanction, and also to satisfy that the authority sanctioning it is competent for the purpose by virtue of the powers vested in it by the provisions of the

Constitution and of the law, rules or orders made thereunder, or by the rules of delegation of financial powers made by an authority competent to do so.

EXAM NOV 20

Ques-29 The audit of receipts of government is not 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.

Ans. 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, realized 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.

EXAM NOV 20, MTP NOV 21

Ques-30 Explain the different types of revenue grants which local bodies may receive.

Ans. 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.

EXAM JAN 21, MTP APRIL 2023

Ques-31 As an Auditor of NGO, how do you check/verify at least four receipts of income during the year?

Ans. The receipt of income of NGO may be checked on the following lines:

- (i) Contributions and Grants for projects and programmes: Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
- (ii) Receipts from fund raising programmes: Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
- (iii) Membership Fees: Check fees received with Membership Register. Ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
- (iv) Subscriptions: Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine/ circulars/periodicals. Check the receipts with subscription rate schedule.
- (v) Interest and Dividends: Check the interest and dividends received and receivable with investments held during the year.

EXAM JAN 21

Ques-32 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

Ans. 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.

MTP MARCH 21

Ques-33 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.

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.

MTP MARCH 21

Ques-34 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.

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.
- (ix) Bank Balance: Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
- (x) Inventory: Verify inventory in hand and obtain certificate from the management for the Quantities and valuation of the same.
- (xi) Programme and Project Expenses: Verify agreement with donor/contributor(s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.
- (xii) Establishment Expenses: Verify that provident fund, life insurance premium, employees state insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

MTP APRIL 21

Ques-35 Briefly explain the provisions for qualification and appointment of Auditors under the Multi-State Co-operative Societies Act, 2002.

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.

RTP MAY 21

Ques-36 Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end. Explain

Ans. Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanor 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

RTP NOV 21

Ques-37 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.

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

The important objectives of audit are:

- (a) reporting on the fairness of the content and presentation of financial statements;
- (b) reporting upon the strengths and weaknesses of systems of financial control;
- (c) reporting on the adherence to legal and/or administrative requirements;

- (d) reporting upon whether value is being fully received on money spent; and
 (e) detection and prevention of error, fraud and misuse of resources.

MTP NOV 21

Ques-38 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. 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

EXAM DEC 21, MTP MARCH 2022

Ques-39 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

Ans. **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.

MTP MARCH 2022

Ques-40 You have been appointed auditor of M/s. BLK Hospital. Discuss important points that would attract your attention while audit.

Ans. **AUDIT OF HOSPITAL**

The important points involved in such an audit are stated below-

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

- (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For eg. copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills etc.
- (iii) **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.
- (iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (vi) **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.
- (vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- (viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- (ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- (x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- (xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- (xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.
- (xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

MTP APRIL 2022

Ques-41. 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.

Ans. (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..

MTP APRIL 2022

Ques-42 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.
 Ans Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession.

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

Government auditing is

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

MTP APRIL 2022

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- (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..

MTP OCT 2022

Ques-44 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

Ans: **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.

MTP OCT 2022

Ques-45 Explain the meaning of Government Audit and also discuss its objectives.

Ans: 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

RTP MAY 2022

Ques-46 Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain.

Ans 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.

RTP MAY 2022

Ques-47 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.

Ans 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:
- 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.
 - 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.

EXAM MAY 2022

Ques-48 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?

Ans. 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 those 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:

(i) vouching the Income-tax refund with the correspondence with the Income-tax Department; and

(ii) checking the calculation of the repayment of claims/refund claim.

EXAM NOV 2022

Ques-49 M / s PQ & Co., Chartered Accountants have been appointed as statutory auditor of CBD Multiplex Cinema Ltd. The audit team started the audit and verified the ledger and other books of accounts for the F.Y 2021-2022. However one of the team members is of the view that the internal control mechanism of the company should also be verified. Can you guide the audit team about the areas that will be covered in verifying the internal control mechanism?

Ans. Areas to be covered while verifying the Internal Control Mechanism in Multiplex: Audit Team of M/s PQ & Co. should cover the following areas to verify the internal control mechanism of CBD Multiplex Cinema Ltd.-

i. that entrance to the cinema-hall during show is only through printed tickets;

ii. that they are serially numbered and bound into books;

iii. 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. that for advance booking a separate series of tickets is issued; and

v. that the inventory of tickets is kept in the custody of a responsible official.

EXAM NOV 2022

Ques-50 CA Sevak is appointed as an auditor of a Municipal Corporation of a big smart city . He wants to verify various expenditures of the Municipality! Define the term "Municipality" and state what are the heads under which ' expenditures incurred by the Municipalities and Corporations can be broadly classified?

Ans. Definition of Municipality & Expenditure incurred by it: Definition: A Municipality can be defined as a unit of local self-government in an urban area. By the term 'local self- government' is ordinarily understood the administration of a locality - a village, a town, a city or any other area smaller than a state - by a body representing the local inhabitants, possessing fairly large autonomy, raising at least a part of its revenue through local taxation and spending its income on services which are regarded as local and, therefore, distinct from state and central services.

Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads:

- (a) general administration and revenue collection,
- (b) public health,
- (c) public safety,
- (d) education,
- (e) public works, and
- (f) others such as interest payments, etc.

EXAM NOV 2022

Ques-51 Ban LLP is formed during the year 2021-22. They are not sure about the type of books of accounts to be maintained. What are the books of accounts that the LLP is required to maintain?

Ans. Books of Accounts Ban LLP is required to maintain: An LLP shall be under obligation to maintain annual accounts reflecting true and fair view of its state of affairs. LLPs are required to maintain books of accounts which shall contain-

1. Particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place,
2. A record of the assets and liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold,
4. Any other particulars which the partners may decide.

MTP MARCH 2023

Ques-52 Explain and also state the role of auditor with respect to the following in case of a hotel:

- (i) Inventories
- (ii) Travel agents & shops

Ans. (i) **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.

(ii) Travel agents & shops:

(i) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.

(ii) Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf.

MTP MARCH 2023

Ques-53 State the points which merit consideration in the audit of a CLUB w.r.t its members Ans. The points which merit consideration in the audit of a CLUB w.r.t its members:

(1) Entrance Fee: Vouch the receipt on account of entrance fees with -

- members' applications and counterfoils issued to them,
- on a reference to minutes of the Managing Committee.

(2) Member Subscriptions: 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) Subscription Arrears/in Advance: Ensure that -

- arrears of subscriptions for the previous year have been correctly brought over,
- arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
- Subscriptions received in advance should have been properly accounted for.

(4) Arithmetical accuracy: Check totals of various columns of the Register of members and tally them across.

(5) Register of Members: 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) Member Accounts:- Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

RTP MAY 2023

Ques-54 The audit of Government expenditure is one of the major components of Government audit. Briefly explain the basic standards set in relation to audit of Government expenditure.

Ans. **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 of funds authorized 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.

RTP MAY 2023

Ques-55 State the important objectives of Local bodies Audit.

Ans. Objective of Audit of Local Bodies: The important objectives of audit of local bodies 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.

EXAM MAY 2023

Ques-56 CA. Z, a Chartered Accountant is the Senior manager of a multi-State co-operative society in Mumbai. He is proposed to be appointed as an auditor of the said Multi-State Co-operative society. Analyse the provisions of the Multi-State Co-operative Societies Act, 2002 and comment on validity of proposed appointment.

Ans: **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.

Considering the facts given in the question, the following persons are not eligible for appointment as auditors of a Multi-State co-operative society-

- (a) An officer or employee of the Multi-State co-operative society.
- (b) A person who is a member or who is in the employment, of an officer or employee of the Multi-State co-operative society.

In view of above, CA, Z being officer of Multi State Co-operative Society is not eligible for appointment as Auditor and therefore proposed appointment of CA Z is not valid .

EXAM MAY 2023

Ques-57 SK & Co, a Chartered Accountant firm has been appointed an auditor of Metro Rail project in City A. Since the project is on large scale it involves a high volume of resources (financial, human and physical resources). The appointing authority C&AG requires an objective examination of the financial and operational performance of the Metro Rail project. Explain the nature and scope of audit that SK & Co will undertake.

Ans: **Performance audit** - The scope of the audit has been extended to cover efficiency, economy and effectiveness audit or performance audit, or full scope audit.

Efficiency audit looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them, i.e., the relationship between goods and services produced and resources used to produce them; and examination aimed to find out the extent to which operations are carried out in an economical and efficient manner.

Economy audit looks into whether the government has acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy.

Effectiveness audit is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives.

Efficiency- cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness

EXAM MAY 2023

Ques-58 CA B is appointed as the auditor of a Public Charitable Trust. Guide him the focus area of attention relating to the vouching and verification of expenditure of charitable institution.

Ans: **Focus area of attention relating to vouching and verification of Expenditure of charitable institution**

- (i) Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the Managing Committee has benefited there from either directly or indirectly.
- (ii) Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test- basis.
- (iii) Verifying the cash and bank payments.
- (iv) Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

RTP NOV 2023

Ques-59 "Public moneys should not be utilized for the benefit of a particular person or section of the community". List out the exceptions to this rule while conducting audit against propriety.

Ans: **Exceptions to the rule - Audit Against Propriety:** Public moneys should not be utilised for the benefit of a particular person or section of the community unless:

- (i) the amount of expenditure involved is insignificant; or
- (ii) a claim for the amount could be enforced in a Court of law; or
- (iii) the expenditure is in pursuance of a recognised policy or custom; and
- (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

RTP NOV 2023

Ques-60 state six important advantages of audit of accounts of a Partnership firm.

Ans: **Advantages of Audit of Accounts of a Partnership:** On broad considerations, the advantages of audit of accounts of a partnership could be stated as follows:

- (1) Audited accounts provide a convenient and reliable means of settling accounts between the partners and, thereby, the possibility of occurrence of a dispute among them is mitigated. On this consideration, it is usually provided in and accepted by the partners, shall be binding upon them, unless some manifest error is brought to light within a specified period subsequent to the accounts having been signed.
- (2) On the retirement or death of a partner, audited accounts, which have been accepted by the partners, constitute a reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.
- (3) The accounts of a partnership, which have been audited, are generally accepted by the Income Tax Department as the basis for computing the assessable income of the partners.
- (4) Audited statement of accounts are relied upon by the banks when advancing loans, as well as by prospective purchasers of the business, as evidence of the profitability of the concern and its financial position.
- (5) Audited statements of account can be helpful in the negotiations to admit a person as a partner, especially when they are available for a number of past years.
- (6) An audit is an effective safeguard against any undue advantage being taken by a working partner or partners especially in the case of those partners who are not actively associated with the working of the firm

PYQ NOV 2023

Ques-61 The relationships between individual financial statements items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities.

PYQ NOV 2023

Ques-62 NGOs registered under the Companies Act, 2013 are not allowed to maintain accounts on cash-basis.

PYQ NOV 2023

Ques-63 Under 'finance lease' lease term generally extends to less than 75% of the projected useful life of the leased asset.

PYQ NOV 2023

Ques-64 In government expenditure audit, audit against provision of funds aims at ensuring that each item of expenditure is covered by sanction, either general or special, of the competent authority

PYQ NOV 2023

Ques-65 CA Z is appointed as the auditor of Chanakya Open University which offers higher learning educational courses through the distance Mode of Education. Discuss four steps involved in his audit of other receipts/ grants and donations received by the University.

PYQ NOV 2023

Ques-66 On 1st May 2022, NGO has been founded with the objective of disaster relief registered under section 8 of the Companies Act, 2013. In addition to corpus contribution, substantial foreign contributions also have been received by NGO. You have been appointed as the first auditor of the said NGO for the F.Y. 2022-23. While planning the audit of NGO which you will focus upon? Mention any four such points.

Chapter-9

Audit of Banks

STUDY MATERIAL NEW

Ques-1 Discuss outline of audit approach including audit procedures while auditing "provisions and contingencies" in financial statements of a bank.

Ans: 1. 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.

2. The auditor should obtain an **understanding as to how the bank computes provision** on standard assets and non-performing assets.

3. 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.

4. The auditor should obtain the **detailed break up of standard loans**, non-performing loans and agree the outstanding balances with the general ledger.

5. 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.

6. 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.

STUDY MATERIAL NEW

Ques-2 Discuss importance of implementation of KYC norms by a bank from perspective of an auditor of bank.

Ans: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. The RBI has from time to time issued guidelines ("Know Your Customer Guidelines - Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

STUDY MATERIAL NEW

Ques-3 List out any four points which highlight peculiarities involved in banking operations.

Ans: **The peculiarities involved in Bank are as follows:**

1. Huge volumes and complexity of transactions;
2. Wide geographical spread of banks' network;
3. Large range of products and services offered;
4. Extensive use of technology;
5. Strict vigilance by the banking regulator etc.

STUDY MATERIAL NEW

Ques-4 Is statutory auditor of a bank required to report on the requirements relating to Companies (Auditor's Report) Order, 2020?

Ans: **No**, Auditor of Bank is not required to report as per CARO, 2020 as CARO, 2020 doesn't apply on Banking Company.

STUDY MATERIAL NEW

Ques-5 Account of a borrower availing cash credit facility from branch of a bank has become "Out of order." Discuss the term "Out of order".

Ans: An account shall be treated as 'out of order' if:-

1. the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
2. 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
3. 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'.

STUDY MATERIAL NEW

Ques-6 The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country. Explain

Ans: **RBI is responsible for :-**

1. development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions)
2. determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour.
3. regulating the activities of commercial and other banks

The Important Functions of RBI are as follows

1. issuance of currency;
2. regulation of currency issue
3. acting as banker to the central and state governments; and
4. acting as banker to commercial and other types of banks including term- lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks.
5. No bank can commence the business of banking or open new branches without obtaining license from RBI. The RBI also has the power to inspect any bank.

STUDY MATERIAL NEW

Ques-7 "The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference". Explain

Ans: **Nature of Discussions with the Engagement Team: -**

- (a) Error that may occur
- (b) Errors that have been occurred in Past Years
- (c) Method by which can be conducted by Bank personnel
- (d) Audit response to identified risk
- (e) Need to maintain Professional Skepticism

STUDY MATERIAL NEW

Ques-8 Write a short note on reversal of income under bank audit.

Ans: 1. If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the **entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised.** This will apply to Government guaranteed accounts also.

2. In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

3. Further, in case of banks which have **wrongly recognised income in the past should reverse the interest** if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).
4. Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are **any communications from borrowers pointing out differences in interest charge** and whether appropriate action has been taken in this regard.

STUDY MATERIAL NEW

- Ques-9 What are the general requirements of an effective Risk Management System in Banks?
- Ans (a) 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.
- (b) 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.
- (c) 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.
- (d) 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.
- (e) 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.

STUDY MATERIAL ,MTP APRIL 2023, RTP MAY 2023,

- Ques-10. Explain the audit approach you would follow to check the Operating Expenses of a Bank
- Ans **Auditing the Operating Expenses of a Bank:-**
- (a) 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.
- (b) Divergent Trends:-The auditor should examine whether there are any divergent trends in respect of major items of expenses.
- (c) 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.
- (d) Vouching & Verification:- The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required

EXAM MAY 18, RTP NOV 20, MTP APRIL 21

- Ques-11. Mr. A approaches a bank for financial assistance for his upcoming project. The bank branch manager, after verifying the proposal, is agreeable to financial Mr. A, but asks for the security of is offered to the bank. Discuss the nature of securities required to be offered to the bank
- Ans **Nature of Security:**
- I. 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.

II. 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

EXAM NOV 18

Ques-12. "Ramjilal & Co. had been allotted the branch audit of a nationalized bank for the year ended 31st March, 2019. In the audit planning, the partner of Ramjilal & Co., observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose. "Now he needs your assistance on the following points so as to incorporate them in the audit plan:

- (a) For determine of NPA norms for agricultural advances
- (b) For accounts where there is erosion in the value of security / frauds. Committed by the borrower

Ans. (a) NPA norms for Agricultural Advances: 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 installment 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 installment of principal or interest thereon remains overdue for one crop season.

- (b) Accounts where there is erosion in the value of security / frauds committed by borrowers

Not prudent to follow stages of asset classification. It should be straightaway classified as doubtful or loss asset as appropriate.

(i) Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

(ii) If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank.

EXAM NOV 18, RTP MAY 19, RTP NOV 19

Ques-13. The auditor should examine the efficacy of various internal controls over advances in case of Banks to determine the nature, timing and extent of his substantive procedures. Explain what is included in the internal controls over advances.

Ans. **Evaluation of Internal Controls over Advances:** The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, inter alia, the following:

1. The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
2. All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
3. The compliance with the terms of sanction and end use of funds should be ensured.
4. Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
5. If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
6. All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
7. In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
8. Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
9. The accounts should be kept within both the drawing power and the sanctioned limit.
10. All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
11. The operation of each advance account should be reviewed at least once a year, and at more frequent intervals in the case of large advances.

EXAM MAY 19, RTP MAY 2023

Ques-14. Mr. Piyush, the bank manager develops controls to aid in managing key business and financial risks. Discuss the various requirements for an effective risk management system in a bank.

OR

Mr Rishikesh, the Bank Manager develops controls to assist in managing key business and financial risks. Discuss the various requirements for an effective risk management system in a bank.

Ans. **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 (BOD/Chief Executive Officer) 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 manage 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 of limits, reporting and approval of exceptions, physical security and contingency planning.
- (iv) Monitoring activities: Risk management models, methodologies and assumptions used to measure and manage 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

Ques-15. You are appointed as an auditor of Banking Co. , and hold discussions with engagement team. List out matters which you would discuss at the planning stage of an audit to gain better understanding of the bank and its environment.

OR

The discussion between members of the engagement team members and the audit engagement partner should be done on the susceptibility of the bank's financial statements to material misstatements. Briefly discuss the points ordinarily included in discussion of the engagement team

Ans. The engagement team discussion ordinarily includes a discussion of the following matters:

- (i) Errors that may be more likely to occur;
- (ii) Errors which have been identified in prior years;
- (iii) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- (iv) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- (v) Need to maintain professional skepticism throughout the audit engagement;
- (vi) Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

RTP NOV 19, RTP MAY 21

Ques-16. 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, among other points, the amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet. Explain

Ans. Audit of Advances: 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 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 that the recoverability of advances is recognised in their valuation.
- (f) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- (g) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

EXAM NOV 19, RTP MAY 2022

Ques-17 "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 nationalized bank.

OR

There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets. Explain in detail.

Ans. Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets which are given below:

CATEGORIES OF NON-PERFORMING ASSET	PROVISION REQUIRED	
Substandard Assets: Would be one, which has remained NPA for a period less than or equal to 12 months.	15%	
Doubtful Assets: Would be one, which has remained in the substandard category for a period of 12 months.		
Sub-categories: Doubtful up to 1 Year (D1) Doubtful 1 to 3 Years (D2) Doubtful more than 3 Years (D3)	Secured 25% 40% 100%	Unsecured 100% 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%	

RTP MAY 20, RTP NOV 21

Ques-18. 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.

Ans. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.

- The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.
- The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences. The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger. The auditor should understand the process of computation of the average balance and re-compute the same on sample basis.
- The auditor should, on a test check basis, verify the calculation of interest and ensure that:
 - Interest has been provided on all deposits upto the date of the balance sheet;
 - Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;
 - Interest on savings accounts are in accordance with the rules framed by the bank/RBI in this behalf.
 - 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.

RTP MAY 20

Ques-19 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. Analyse and Explain.

Ans Reversal of Income: If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).

Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard.

MTP OCTOBER 20

Ques-20. Your firm of Chartered Accountants has been appointed as auditor of a Nationalized bank. Explain how you will proceed to carry out audit of provisions and contingencies.

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.

RTP NOV 20

Ques-21. Depending on the nature of the item concerned, creation of security may take the form of a mortgage, pledge, hypothecation, assignment, set-off or lien. Explain with specific reference to Audit of Banks.

Ans. Depending on the nature of the item concerned, creation of security may take the form of a mortgage, pledge, hypothecation, assignment, set-off or lien.

(i) **Mortgage:** Mortgage are of several kinds but the most important are the Registered Mortgage and the Equitable Mortgage.

- Registered Mortgage can be affected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security.
- Equitable mortgage, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

(ii) **Pledge:** A pledge thus involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains

with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.

(iii) 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 favour 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.

(iv) Assignment: Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favour 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.

(v) Set-off Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set-off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right (i.e., the capacity of the account holder in both the accounts should be the same).

For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.

(vi) Lien: Lien is creation of a legal charge with consent of the owner, which gives lender a legal right to seize and dispose / liquidate the asset under lien.

EXAM NOV 20

Ques-22. You are appointed as Statutory Auditor of DEF Bank Limited for the year 2020-21. As an Auditor-how will you verify Provisions created by DEF Bank Limited?

Ans. 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.

EXAM JAN 21

Ques-23. As an Auditor of XYZ Bank Limited, how would you assess the Risk of Fraud including Money Laundering in line with SA 240?

Ans. As an Auditor of XYZ Bank Limited, risk of fraud including money laundering would be assessed as explained hereunder which is in line with SA 240.

As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. The RBI has from time to time issued guidelines ("Know Your Customer Guidelines - Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

MTP MARCH 21

Ques-24. There are different types of banks prevailing in India. Explain giving examples of such 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 & Mobilebanking. 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.

MTP APRIL 21, MTP OCTOBER 21

Ques-25. In case of a Bank, explain the meaning of funded loans. Also give examples.

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

RTP MAY 21

Ques-26 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.

Ans. Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

- (a) Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.

- (b) Long Form Audit Report. (LFAR)
- (c) Report on compliance with SLR requirements.
- (d) Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.
- (e) Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.
- (f) Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.
- (g) Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.
- (h) Report on instances of adverse credit-deposit ratio in the rural areas.

EXAM JULY 21

Ques-27. 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

Ans. **Out of Order: An account should be treated as 'out of order' if:**

1. The outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
2. 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
3. Credits are there but are not enough to cover the interest debited during the same Period, these accounts should be treated as 'out of order'.

Applying the above to the given case of N Ltd, its Drawing power is ₹ 80 Lakhs, although outstanding balance in the account is ₹ 75 Lakhs, but still the account would be reported as out of order because credits in the account are not sufficient to cover the interest debited during the same period

EXAM JULY 21, RTP NOV 21

Ques-28. Discuss the advantages of engagement team discussion done at the planning stage of the bank audit
OR

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.

Ans. Advantages of engagement team discussion done at the planning stage of Bank audit are:

- Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
- Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

MTP NOV 21, EXAM JAN 21

Ques-29. Explain "Advances under Consortium" in the context of Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

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.

EXAM DEC 21, MTP APRIL 2023

Ques-30. 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

Ans. **Computation of Drawing Power:**

(i) 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.

(ii) 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.

(iii) 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.

(iv) Stock Audit: The stock audit should be carried out by the bank for all accounts having funded exposure of more than ₹ 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.

EXAM DEC 21, MTP MARCH 2022

Ques-31. Explain the categories of Agricultural Advances in case of Banks and related NPA norms

Ans. **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.

MTP APRIL 2022

Ques-32. 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

Ans. 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.

MTP OCT 2022

Ques-33 When is an agricultural advance considered as non-performing as per the RBI guidelines ?

Ans: **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.

MTP OCT 2022

Ques-34 Explain hypothecation and assignment as the modes of creation of security with respect to advanced granted by a bank.

Ans: **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.

RTP MAY 2022

Ques-35. For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses

Ans. 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.

RTP MAY 2022

Ques-36. 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.

Ans. 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.

EXAM MAY 2022

Ques-37 Compute the Drawing Power for Cash Credit A / c of S Limited for the month of March 2022 with following information:

(Amount in ₹)

Stock 50,000

Debtors 45,000

(Including Debtor of 2 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

Ans. Computation of Drawing Power for CC A/c of S Ltd.

Particulars of current assets		Amount (₹)	DP Amt (₹)
(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 ` 45000 whereas drawing power as per the above working is ` 48000. So, drawing power would be restricted to sanctioned limit i.e., ` 45000

EXAM MAY 2022

Ques-38. 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?

Ans. 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.

EXAM NOV 2022

Ques-39 CARD Ltd. is into the banking business and handles large amount of loans and advances of different kinds. Non - performing assets are on the rise since last two quarters. The management is concerned with correct provisioning for the same. CA R is appointed to check whether correct provisioning of NPA's is being made by the bank or not. What are the aspects that will be verified by CA R for this purpose?

Ans. Provisioning of Non-performing Assets: CA R should verify that the classification of NPAs into sub-standard assets, doubtful assets and loss assets is done depending upon prudential norms as per the RBI Guidelines. Further he should also ensure that provision is being made for the same in accordance with the given table:

Categories of Non-Performing Assets: Substandard Assets:	Provision required
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<p>Would be one, which has remained NPA for a period less than or equal to 12 months.</p> <p>Doubtful Assets: Would be one, which has remained in the substandard category for a period of 12 months.</p> <p>Sub-categories:</p> <ul style="list-style-type: none"> • Doubtful up to 1 Year (D1) • Doubtful 1 to 3 Years (D2) • Doubtful more than 3 Years (D3) <p>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.</p>	<p>15%</p> <p>(Secured + Unsecured) 25% + 100%</p> <p>40% + 100%</p> <p>100% + 100%</p> <p>100%</p>
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MTP MARCH 2023

Ques-40 When are following considered as non performing as per the RBI guidelines?

- (i) Government guaranteed advances
- (ii) Advances to staff

Ans. **Government Guaranteed advances:**

Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.

The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

Advances to Staff

Interest-bearing staff advances as a banker should be included as part of advances portfolio of the bank. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets.

MTP MARCH 2023

Ques-41. Explain pledge and set off as the modes of creation of security with respect to advance granted by a bank.

Ans. **Pledge:** A pledge involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.

Set-off: Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set-off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right (i.e., the capacity of the account holder in both the accounts should be the same). For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.

EXAM MAY 2023

Ques-42. A Ltd. has availed Cash Credit facilities against Stock and Book Debt, Term Loan for machineries and Bank Guarantee from Big Bank Ltd. A Ltd. furnishes stock statements and age wise list of debtors to Big Bank Ltd. on regular basis. Concurrent Auditors of Big Bank Ltd. mentioned about wrong calculation of Drawing Power by the Bank Branch along with sanctioned limit, and balances overdrawn due to wrong calculation of Drawing Power (DP) in the monthly report, Explain the meaning of drawing power and how it differs from sanctioned limit? What is to be ensured while computing Drawing Power (DP)?

Ans: **Meaning of Drawing Power** generally addressed as "DP" is an important concept for Cash Credit (CC) facility availed from banks and financial institutions. Drawing power is the limit up to which a firm or company can withdraw from the working capital limit sanctioned.

Different from Sanctioned Limit: The Sanctioned limit is the total exposure that a bank can take on a particular client for facilities like cash credit, overdraft, export packing credit, non-funded exposures etc. On the other hand, Drawing Power refers to the amount calculated based on primary security less margin as on a particular date.

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.

EXAM DEC 21, MTP MARCH 2022

Ques-43 The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. Explain this statement.

Ans. The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, inter alia, the following:

- The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
- All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
- The compliance with the terms of sanction and end use of funds should be ensured.
- Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
- If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
- All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
- In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
- Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
- The accounts should be kept within both the drawing power and the sanctioned limit. • All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
- The operation of each advance account should be reviewed at least once a year and at more frequent intervals in the case of large advances.

RTP NOV 2023

Ques-44 Your firm has been appointed as branch auditor of SP Bank Ltd. Discuss about the primary evidence you will look into while carrying out verification of advances.

Ans: Verification of Advances: 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:

- (i) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- (ii) Advances represent amount due to the bank.
- (iii) Amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances.
- (iv) The stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation.
- (v) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- (vi) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.
- (vii) There are no unrecorded advances.

RTP NOV 2023

Ques-45 TEP Industries Private Limited, a company engaged in obtaining rice from paddy, is enjoying a cash credit facility against hypothecation of paid stocks and book debts (eligible up to 90 days only) from LMV Bank for ₹4.00 crore. The letter sanctioning the above credit facility stipulates margin @ 25% on stocks and @ 40% on eligible book debts up to 90 days.

While preparing stock statement as on 30.6.23, accountant of the company calculates value of stocks for ₹5 crore (including 1 crore of rice which was lying in a low lying godown and was completely damaged during recent floods caused by river Yamuna) Debtors outstanding as on 30.6.23 are ₹ 3 crore (including 50 lacs outstanding for last 6 months) Trade creditors outstanding as on date are 2 crore. He calculates DP as on 30. 6. 23 for 3.30 crore. Is he correct? Justify with your workings.

What does drawing power calculated by you signify to the borrower company?

Ans: The calculation of DP is as under:

Value of stocks as on 30.6.23	' 5.00 crore
Less: value of damaged stocks	' 1.00 crore
Value of stocks considered as on 30.6.23	' 4.00 crore
Less: trade creditors	' 2.00 crore
Paid stocks	' 2.00 crore
Less: Margin @ 25%	' 0.50 crore
Drawing power for stocks [A]	' 1.50 crore
Value of Trade debtors	' 3.00 crore
Less: debtors outstanding for more than 90 days	' 0.50 crore
	' 2.50 crore
Less: Margin @ 40%	' 1.00 crore
Drawing power for Book debts [B]	' 1.50 crore
Total drawing power [A+B]	' 3.00 crore

Accountant's DP calculation is not correct. The drawing power of ` 3.00 crore signifies that company can utilize funds to the tune of ` 3.00 crore only against sanctioned cash credit limit of ` 4.00 crore

Chapter-10

Standards on Auditing

SA-200

RTP MAY 19

Ques-1 (a) Explain the overall objective of the auditor as contained in SA 200.

(b) The IAASB functions as an independent standard-setting body under the auspices of IFAC. Explain stating the objective of IAASB and also how it achieves those objectives.

Ans. (a) As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

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

(ii) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

(b) Objectives of International Auditing and Assurance Standards Board: In 1977, the International Federation of Accountants (IFAC) was set up with a view to bringing harmony in the profession of accountancy on an international scale. In pursuing this mission, the IFAC Board has established the International Auditing and Assurance Standards Board (IAASB) to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world. The IFAC Board has determined that designation of the IAASB as the responsible body, under its own authority and within its stated terms of reference, best serves the public interest in achieving this aspect of its mission.

The IAASB functions as an independent standard-setting body under the auspices of IFAC. The objective of the IAASB is to serve the public interest by setting high quality auditing standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. The IAASB achieves this objective by:

- ✦ Establishing high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, banking regulators, securities regulators and other key stakeholders across the world;
- ✦ Establishing high quality standards and guidance for other types of assurance services on both financial and non-financial matters;
- ✦ Establishing high quality standards and guidance for other related services;
- ✦ Establishing high quality standards for quality control covering the scope of services addressed by the IAASB; and Publishing other pronouncements on auditing and assurance matters, thereby advancing public understanding of the roles and responsibility of professional auditors and assurance service providers.

RTP MAY 20

Ques-2 Explain the objectives of an Audit as per SA 200.

Ans. As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

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

(b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

RTP NOV 20

Ques-3 Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. The

auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated. Explain giving examples.

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

Professional skepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence 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.
- Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:
- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

MTP OCT 20

Ques-4 "Professional judgment is essential to the proper conduct of an audit." Discuss.

Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- (i) Materiality and audit risk.
- (ii) The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence.
- (iii) Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.
- (iv) The evaluation of management's judgments in applying the entity's applicable financial reporting framework.
- (v) The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

MTP OCT 20

Ques-5 DEF & Co. Chartered Accountants successfully carried out the audit of Shree Garments or the f.y. 2019-2020. After the completion of the audit, there were found material misstatements due to fraud in the financial statements which were not noticed and reported by the auditor. Management alleges that it is failure on the part of auditor. Comment.

Because of the limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with SAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

EXAM MAY 22, MTP APRIL 23

Ques-6 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 ?

OR

CA Jatin is the auditor of JP 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. Explain w.r.t SA 200.

Ans. Overall Objectives of the Independent Auditor: As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (i) 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
- (ii) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

In the given case of SR Ltd, CA N expressed his opinion on the financial statements of SR Ltd without obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement or not. Therefore, it can be concluded that CA N did not comply with the objective of audit as stated in SA 200.

MTP APRIL 23

Ques-7 The newly appointed auditor of Parag 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 ?

Ans: **Audit Procedure Regarding Opening Balances:** The newly appointed auditor of Parag 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 Parag 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.

RTP NOV 2023

Ques-8 Mr. Z, auditor of the company, Different and capable Limited for the financial year 2022-23, explained to audit team members about the objectives of the independent Auditor in accordance with the relevant Standard on Auditing. Explain those objectives.

Ans: As per SA-200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing, in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, 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.

SA-210

STUDY MATERIAL OLD

Ques-1 A Chartered accountant is conducting audit of a client for last two years. Before proceeding to start audit for next year, he notices that there is substantial change in management. Besides, client has ventured into areas of business activity which were not present at time of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210.

Ans: **Recurring audit is an audit which is performed by an auditor over years.** 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:

- (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.

PYQ DEC 2021

Ques-2 CA S is requested to accept the appointment as an auditor of Luck Ltd. With reference to SA 210, what should the auditor determine in order to establish whether the preconditions for an audit are present?

Ans: **SA 210-Agreeing the Terms of Audit Engagements:**

In order to establish whether the preconditions for an audit are present, the auditor of Luck Ltd, CA S shall:

- (1) Determine whether the financial reporting framework is acceptable; and
- (2) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework;
 - (ii) For the internal control as management considers necessary, and
 - (iii) To provide the auditor with:
 - Access to all information such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit, and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

RTP NOV 19

Ques-3. 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 stating the factors based on which client can request the auditor to change the engagement.

Ans. 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.

RTP MAY 21

Ques-4. 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.

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

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

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior 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.

RTP MAY 21

Ques-5 Discuss preconditions for an audit as per SA 210. Explain how would an auditor proceed to establish the presence of pre conditions for an audit.

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

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

- (a) Determine whether the financial reporting framework is acceptable; and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework;
 - (ii) For the internal control as management considers necessary; and
 - (iii) To provide the auditor with:

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

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

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

MTP MARCH 2022

Ques-6. As an auditor of XYZ Ltd, how would you consider the acceptance of a change in audit engagement?

Ans Acceptance of a Change in Engagement:

1. 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.
2. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

3. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to:

- (1) the original engagement; or
- (2) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

4. The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

5. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

6. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

- (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
- (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

MTP SEPT 2022

Ques-7 CA Raj, an engagement partner wants to establish whether the preconditions for an audit are present. Guide CA Raj in this context.

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

- (1) Determine whether the financial reporting framework is acceptable; and
- (2) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework.
 - (ii) For the internal control as management considers necessary; and
 - (iii) To provide the auditor with:
 - Access to all information such as records, documentation and other matters.
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

MTP OCT 2022

Ques-8 The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate operating effectively and complied with in practice. Explain the purpose of monitoring compliance with quality control policies and procedures.

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

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

- (1) Adherence to professional standards and regulatory and legal requirements;
- (2) Whether the quality control system has been appropriately designed and effectively implemented; and
- (3) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

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

EXAM NOV 2022

Ques-9 CA P is appointed as an auditor of XYZ Limited for the F.Y. 2021-22. The management of XYZ Limited has requested the auditor to change the terms of original engagement as the company has diversified its business and few new products have been introduced by the company. Can CA P agree to the request made by the management? Under which circumstances can the client make a request to the auditor for a change in the terms of engagement?

Ans. Acceptance of a Change in Engagement:

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, a significant change in nature or size of the entity's business is one of the factors which may make it appropriate to revise the terms of the audit engagement.

In the given situation, XYZ Limited has diversified its business and few new products have also been introduced by the Company which is indicative of significant change in nature or size of the entity's business. In view of above, CA. P can agree to the request made by the management to change the terms of the audit engagement. Therefore, request of Management to change the terms of audit engagement is appropriate.

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.

RTP NOV 2023

Ques-10 "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." Discuss.

Ans: Acceptance of a Change in Engagement: 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 a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to-

- (i) the original engagement, or
- (ii) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall-

- (i) Withdraw from the audit engagement where possible under applicable law or regulation; and
- (ii) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

PYQ NOV 2023

Ques-11 The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." Give a brief description about management's responsibilities in the auditor's report as it helps to explain the users the premise on which an audit is conducted. Also state the requirement specified in Standard on Auditing 210 for the auditor to agree management's responsibilities.

SA-220

STUDY MATERIAL OLD

Ques-1 An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility?

Ans: Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. 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.

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

PYQ MAY 2019

Ques-2 CA Raj an engagement partner wants to take decision regarding acceptance and continuance of an audit engagement. Which information he should obtain before accepting an engagement?

Ans: SQC 1 requires the firm to obtain information before accepting an engagement Information such as the following assists the engagement partner in determining whether the decisions regarding the acceptance and continuance of audit engagements are appropriate:

- (i) The integrity of the principal owners, key management and those charged with governance of the entity
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources.
- (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

RTP NOV 19, RTP NOV 20

Ques-3 The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures.

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

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

- (a) Adherence to professional standards and regulatory and legal requirements;
- (b) Whether the quality control system has been appropriately designed and effectively implemented; and
- (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

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

RTP NOV 20, RTP MAY 23

Ques-4 As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. Explain

clearly stating the meaning of engagement partner and also the actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement.

Ans. As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned.

The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasize:

- (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.

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

RTP MAY 21, MTP MARCH 23

Ques-5 Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Explain the matters to be addressed in this context.

OR

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

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

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

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

MTP NOV 21

Ques-6 As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client. Explain stating clearly the information that would assist the auditor in accepting and continuing of relationship with the client.

Information which assist the Auditor in accepting and continuing of relationship with Client: As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to

continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The integrity of the principal owners, key management and those charged with governance Of the entity;
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

RTP NOV 21

Ques-7 The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Discuss the personnel issues addressed by such policies and procedures. Also explain how addressing the personnel issues would empower the firm.

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

Such policies and procedures address the following personnel issues:

- (a) Recruitment;
- (b) Performance evaluation;
- (c) Capabilities;
- (d) Competence;
- (e) Career development;
- (f) Promotion;
- (g) Compensation; and
- (h) Estimation of personnel needs.

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

PYQ NOV 2023

Ques-8 The engagement partner shall form a conclusion on compliance with independence requirements that apply to an audit engagement. State the relevant requirements as per SA 220-Quality control for an audit of Financial Statements.

PYQ NOV 2023

Ques-9 An auditing firm should monitor compliance with quality control policies and procedures. Discuss the purpose of this

SA-230

STUDY MATERIAL OLD

Ques-1 The form, content and extent of audit documentation depends upon number of factors. List out any four such factors.

Ans: The form, content and extent of audit documentation depend on factors such as:

1. The size and complexity of the entity.
2. The nature of the audit procedures to be performed.
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified.
6. 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.
7. The audit methodology and tools used.

STUDY MATERIAL OLD

Ques-2 "Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits". Explain.

Ans: 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.

PYQ MAY 2019

Ques-3 Though legally auditor may exercise the right of Lien in case of companies, it is mostly impracticable for legal and practicable constraints. Do you agree?

Ans: Right of Lien means any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents.

Under section 128 of the Companies Act 2013, In case of company, books of accounts must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Companies Act 2013.

Taking an overall view of the matter, it seems to be correct that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints.

PYQ JULY 2021

Ques-4 Documentation of audit plan serves as a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. What all activities in the planning phase should form part of auditor's documentation? State with examples.

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

Example

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

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

MTP OCT 21

Ques-5 Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered. Further, it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Explain giving examples.

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

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.
- In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
- For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
- Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315.

RTP MAY 19

Ques-6 (a) What do you mean by Audit Documentation? Also explain the nature and purpose of audit documentation.

(b) 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.

Ans. (a) 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.

(b) 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:

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

- Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter Paragraph in the auditor's report. An important 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.

Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).

Some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:

- The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement.
- The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

RTP NOV 19

Ques-7 (a) SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files. Explain

Ans. 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.

RTP NOV 19

Ques-8 Discuss the meaning and nature of Audit Documentation.

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

Objectives of the auditor regarding going concern The objectives of the auditor are:

- (a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- (b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

RTP NOV 19

Ques-9 Explain clearly objective of the auditor regarding written representation.

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

Objectives of the auditor regarding going concern The objectives of the auditor are:

- (a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- (b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

MTP OCT 20

Ques-10 Give some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment where the matters and judgments are significant.

Some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:

- ◆ The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement.
- ◆ The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- ◆ The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic..

RTP NOV 20

Ques-11 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.

Ans. Judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters include:

1. Matters that give rise to significant risks.
2. 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.
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. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).

RTP MAY 21

Ques-12 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.

Ans. **The following are the purpose of Audit documentation:**

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections in accordance with SQC1
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.

RTP MAY 21

Ques-13 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.

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

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

MTP OCT 20, MTP MARCH 21

Ques-14 The working papers of the branch auditor are also the property of the Principal Auditor and the Management of the Company, so they have right to access them. State the relevant SA and comment.

Ans. Ownership of Working Papers: As per SA 230 "Audit Documentation", working papers are the property of the auditor. He may at his discretion, make available portions or extracts from his working paper to his client. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers.

An auditor is not required to provide the management/ clients or other auditors' access to his working papers. Main auditor of the company does not have right of access to the working papers of the branch auditor.

In the case of a company, the main auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch but cannot ask for the copy of working paper and therefore, the branch auditor is under no compulsion to give photocopies of his working paper to the principal auditor.

From above, it is clear that working papers of the branch auditor are his property only and neither the Principal auditor nor management has right to access that. Therefore, statement given in the question is incorrect.

MTP MAY 20

Ques-15 Completion Memorandum" is helpful as part of the audit documentation. Explain. Completion Memorandum or Audit Documentation Summary.

The auditor may consider it helpful to prepare and retain as part of the audit documentation 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.

MTP MARCH 21

Ques-16 Audit documentation serves a number of purposes. List such purposes.

Ans. **The following are the purpose of Audit documentation:**

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections in accordance with SQC1.
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

EXAM MAY 2022

Ques-17 CA G, auditor of Sports Ltd., while auditing documented all the papers. He retained some of the documents of the company on which he has not worked along with the documents which were his working papers saying that as he was the auditor of the Company, so he has the right to retain all the documents as he may require them for future references. Comment the action of the auditor.

Ans. Right of Lien on the Books and Documents of the Company: Under section 128 of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

In view of above, CA G cannot retain the documents of the company and on which he did not work.

EXAM NOV 2022

Ques-18 CA M 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.

Ans. Purpose of Audit Documentation: As per SA 230, "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 in accordance with SQC 1.
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

RTP MAY 2022

Ques-19 TRS & Associates, Chartered Accountants, having completed the audit of Genuine Leathers Ltd has started the assembling of final audit file. TRS & Associates has established policies and procedures for the timely completion of the assembly of audit files. Explain the various aspects related to final audit file discussed in SA 230 giving specific reference to SQC 1, wherever required.

Ans. The auditor TRS & Associates, Chartered Accountants 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.

(i) 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.

(ii) 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.

(iii) 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:

- (i) Deleting or discarding superseded documentation.
- (ii) Sorting, collating and cross-referencing working papers.
- (iii) Signing off on completion checklists relating to the file assembly process.

- (iv) 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.
- (v) 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.
- (vi) 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.

RTP NOV 2023

Ques-20 Audit Documentation refers to the record of three items. Explain stating clearly the objective and nature of audit documentation.

Ans: 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.

RTP NOV 2023

Ques-21 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.

Ans: 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.

SA-260

STUDY MATERIAL NEW

Ques-1 In what ways an effective two-way communication between auditor and those charged with governance is important?

Ans: Communication from auditor is important with those charged with governance. An effective two-way communication is important in assisting: -

(a) The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.

(b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and

(c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

SA-265

STUDY MATERIAL NEW

Ques-1 List out some matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency".

- # 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 volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- # The importance of the controls to the financial reporting process, for example:
 - i. General monitoring controls (such as oversight of management).
 - ii. Controls over the prevention and detection of fraud.
 - iii. Controls over the selection and application of significant accounting policies.
 - iv. Controls over significant transactions with related parties.
 - v. Controls over significant transactions outside the entity's normal course of business.
 - vi. 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.

SA-299

RTP NOV 19, MTP APRIL 23

Ques-1 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.

Ans. 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:

- (i) Sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower workload.
- (iv) Better quality of performance.
- (v) Improved service to the client.
- (vi) Displacement of the auditor of the company taken over in a takeover often obviated.
- (vii) 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.
- (viii) Lower staff development costs.
- (ix) Lower costs to carry out the work.
- (x) A sense of healthy competition towards a better performance

RTP MAY 20

Ques-2 Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard.

Ans. Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:

- (a) identify division of audit areas and common audit areas;
- (b) ascertain the reporting objectives of the engagement;
- (c) consider and communicate among all joint auditors the factors that are significant
- (d) in directing the engagement team's efforts;
- (e) Consider the results of preliminary engagement activities, or similar engagements performed earlier.
- (f) Ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

EXAM NOV 22

Ques-3 HMB Limited's business has grown from one state of India to various countries of the world. Since the business has increased manifold, management decided to appoint joint auditors for conducting the statutory audit of the company. They appointed three CA firms for it. For which audit work the joint auditors will be jointly & severally responsible?

Ans. Joint Audit of Financial Statements:

As per SA 299, "Joint Audit of Financial Statements", all the joint auditors shall be jointly and severally responsible for:

- i. the audit work which is not divided among the joint auditors and is carried out by all joint auditors;
- ii. decisions taken by all the joint auditors under audit planning in respect of common audit areas;
- iii. matters which are brought to the notice of the joint auditors by any one of them and there is an agreement among the joint auditors on such matters;
- iv. examining that the financial statements of the entity comply with the requirements of the relevant statutes;
- v. presentation and disclosure of the financial statements as required by the applicable financial reporting framework;

vi. ensuring that the audit report complies with the requirements of the relevant statutes, applicable Standards on Auditing and other relevant pronouncements issued by ICAI.

SA-300

STUDY MATERIAL NEW

Ques-1 Discuss how performing preliminary engagement activities as part of planning an audit assists auditor.
Ans. Performing preliminary engagement activities assists the auditor in identifying and evaluating events or circumstances that may affect auditor's ability to plan and perform audit engagement.

STUDY MATERIAL NEW

Ques-2 Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to client.

Ans. The auditor shall continuously evaluate compliance with ethical requirements including independence. "Independence" means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.
 The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall: -

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

STUDY MATERIAL NEW

Ques-3 An auditor of a company fails to document audit strategy and audit plan. Briefly outline consequences of such failure.

Ans. 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.

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

STUDY MATERIAL NEW

Ques-4 SA 300 states that auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. Discuss few factors affecting such supervision and review of work of engagement team members.

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

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

STUDY MATERIAL

Ques-5 "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". Explain.

Ans. 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

STUDY MATERIAL

Ques-6 Is it necessary to document the audit plan? If so, what all activities in the planning phase needs to be documented? State with Examples.

Ans. **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.

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.

Example

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

A summary of discussions with the entity's key decision makers.

Documentation of audit committee pre-approval of services, where required. Audit documentation access letters.

Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services.

Auditor's report on the entity's financial statements.

Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter).

STUDY MATERIAL, RTP NOV 19, RTP MAY 21

Ques-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.

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

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

RTP NOV 19

Ques-8 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.

Ans. 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.

RTP MAY 20

Ques-9 (a) Plans should be further developed and revised as necessary during the course of the audit. Explain.
(b) Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The process of establishing the overall Audit strategy assists the auditor to determine such matters as for example - the resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters. Explain the other three such matters.

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

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

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

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

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

RTP NOV 20

Ques-10 The auditor shall document the overall audit strategy, the audit plan and any significant changes made to the overall audit strategy or the audit plan. Explain in detail giving examples

Ans. **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.

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.

Example

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

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

MTP OCT 21, MTP NOV 21

Ques-11 In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement" Explain those considerations in detail.

In establishing the overall audit strategy, the auditor shall:

- (a) Identify the characteristics of the engagement that define its scope;
 - (b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
 - (c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
 - (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
 - (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.
- (d) Funded loans are those loans where there is an actual transfer of funds from the bank to the borrower.

MTP APRIL 22

Ques-12 You have been appointed as an auditor of MKP Ltd. for the first time. Discuss briefly, the factors to be considered by you while establishing overall audit strategy.

Ans. As per SA-300, "Planning an Audit of Financial Statements", 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. In establishing the overall audit strategy, the auditor shall:

- (i) Identify the characteristics of the engagement that define its scope;
- (ii) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- (iii) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- (iv) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- (v) Ascertain the nature, timing and extent of resources necessary to perform the engagement

MTP APRIL 23

Ques-13 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.

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

- (i) The entity's timetable for reporting, such as at interim and final stages.
- (ii) The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work.
- (iii) The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
- (iv) The discussion with management regarding the expected communications on the status of audit work throughout the engagement

EXAM MAY 23

Ques-14 CA D has been appointed as an auditor of LMP Ltd. Before developing an overall audit plan, CA D wants to get an understanding and knowledge of the Client's business including applicable financial reporting framework. Guide CA D in understanding of the same with reference to the relevant Standard on Auditing.

Ans: Understanding and Knowledge of the Client's Business

It is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA 315 Identifying and Assessing the Risk of Material

Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the following

- (1) Relevant industry, regulatory and other external factors including the applicable financial reporting framework.
- (2) 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 the entity is structured and how it is financedto enable the auditor to understand the classes of transactions, account balances and disclosures to be expected in the financial statements
- (3) 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
- (4) The entity's objectives and strategies and those related business risks that may result in risks of material misstatement
- (5) The measurement and review of the entity's financial performance

EXAM MAY 18, MTP OCT 20

Ques-15 M & Co. was appointed as auditor of IGI Ltd. As an auditor what are the factors that would be considered in the development of overall audit plan?

OR

Your firm has been appointed as an auditor to audit the accounts of an auto parts manufacturer, ABC LTD. Elucidate the matters to be considered by an auditor in developing his overall plan for the expected scope and conduct of audit.

Ans. Development of an Overall Plan: The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit-

- The terms of his engagement and any statutory responsibilities.
- The nature and timing of reports or other communication.
- The applicable legal or statutory requirements.
- The accounting policies adopted by the client and changes in those policies.
- The effect of new accounting or auditing pronouncements on the audit.
- The identification of significant audit areas.
- The setting of materiality levels for audit purposes.
- Conditions requiring special attention, such as the possibility of material error or fraud or the involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- The degree of reliance he expects to be able to place on accounting system and internal control.
- Possible rotation of emphasis on specific audit areas.
- The nature and extent of audit evidence to be obtained.
- The work of internal auditors and the extent of their involvement, if any, in the audit.
- The involvement of other auditors in the audit of subsidiaries or branches of the client.
- The involvement of experts.
- The allocation of work to be undertaken between joint auditors and the procedures for its control and review.
- Establishing and coordinating staffing requirements.

EXAM NOV 2018, RTP Nov 19, RTP NOV 21, MTP MARCH 2023

Ques-16 "An adequate planning benefits the audit of financial statements." Discuss

OR

Engagement partner of Audit Firm MKC AND COMPANY thinks that planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning would benefit the audit of financial statements in several ways. Analyse explaining the benefits of adequate planning. (

OR

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 such benefits of planning in the audit of financial statements.

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

1. Helping the auditor to devote appropriate attention to important areas of the audit.
2. Helping the auditor identify and resolve potential problems on a timely basis.
3. Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
4. 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.
5. Facilitating the direction and supervision of engagement team members and the review of their work.
6. Assisting, where applicable, in coordination of work done by auditors of components and experts.

EXAM MAY 19

Ques-17 Describe how the process of establishing the overall audit strategy assists the auditor in marshalling his human resources.

Ans. 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.

RTP NOV 19

Ques-18 Plans should be made to cover acquiring knowledge of the client's accounting Systems, policies and internal control procedures. Explain.

Ans. The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.

Plans should be made to cover, among other things:

- (a) acquiring knowledge of the client's accounting systems, policies and internal control procedures;
- (b) establishing the expected degree of reliance to be placed on internal control;
- (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (d) coordinating the work to be performed.

From the above, it is clear that statement given in the question is partly correct.

MTP MARCH 21

Ques-19 "The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner." Explain stating the matters to be covered in plans.

Ans. "The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business".

Plans should be made to cover, among other things:

- (i) Acquiring knowledge of the client's accounting systems, policies and internal control procedures;
- (ii) Establishing the expected degree of reliance to be placed on internal control;
- (iii) Determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (iv) Coordinating the work to be performed.

RTP NOV 21

Ques-20 The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain those factors.

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

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).
4. The capabilities and competence of the individual team members performing the audit work.

RTP MAY 2022

Ques-21 Engagement Partner CA Hitesh Kapur of Kapur and Associates wanted to develop an audit plan of Sampurna Fabrics Ltd. Discuss the matters to be described in such an audit plan

Ans **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.

Example

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.

RTP MAY 2022

Ques-22 Without adequate knowledge of client's business, a proper audit is not possible. The auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. Explain giving examples.

Ans Knowledge of the client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the

auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

Example

1. If one of management's objectives is to grow the business, management may develop a strategy of steady but regular growth through specific marketing campaigns and development of new markets. Alternatively, management may develop a more aggressive, complex strategy of acquiring competitors. Each of these strategies gives rise to differing business risks and potentially differing risks of material misstatement.
 2. Examples of potential business risks include:
 - (i) Failure to keep up to date with new products, technologies or services.
 - (ii) Excessive reliance on a key supplier, product or individual, such as the owner.
 - (iii) Lack of personnel with expertise to react to changes in the industry.
 - (iv) Insufficient or excessive production capacity caused by inaccurate estimation of demand.
- Loss of financing due to the entity's inability to meet financial covenants

RTP MAY 2023

Ques-23 SA 300 states that auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. What matters should be covered in such Plan by the auditor?

Ans. The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.

Plans should be made to cover, among other things:

- (i) acquiring knowledge of the client's accounting systems, policies and internal control procedures;
- (ii) establishing the expected degree of reliance to be placed on internal control;
- (iii) determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (iv) coordinating the work to be performed.

RTP MAY 2023

Ques-24 Adequate planning benefits the audit of financial statements in several ways. Explain

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

- (a) Helping the auditor to devote appropriate attention to important areas of the audit.
- (b) Helping the auditor identify and resolve potential problems on a timely basis.
- (c) Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- (d) 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.
- (e) Facilitating the direction and supervision of engagement team members and the review of their work.
- (f) Assisting, where applicable, in coordination of work done by auditors of components and experts.

RTP MAY 2023

Ques-25 In establishing the overall audit strategy, the auditor shall identify the characteristics of the engagement that define its scope. Explain with example.

Ans. In establishing the overall audit strategy, the auditor shall identify the characteristics of the engagement that define its scope.

For Example :

- The expected audit coverage, including the number and locations of components to be included.
- The nature of the business segments to be audited, including the need for specialized knowledge.
- The expected use of audit evidence obtained in previous audits, for example, audit evidence related to risk assessment procedures and tests of controls.

SA-315

STUDY MATERIAL NEW

Ques-1 Discuss how "analytical procedures" performed as "risk assessment procedures" can be useful to an auditor.

Ans. Risk assessment procedures are a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

STUDY MATERIAL NEW

Ques-2 What is understood by "non-routine" transactions? Briefly outline why risks of material misstatement is greater for such transactions.

Ans. Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty. Significant risks are inherent risks with both a higher likelihood of occurrence and a higher magnitude of potential misstatement. The auditor assesses assertions affected by a significant risk as higher inherent risk. The following are always significant risks:

- a) Risks of material misstatement due to fraud
- b) Significant transactions with related parties that are outside the normal course of business for the entity

PYQ JULY 2021

Ques-3 CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which includes observation and inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations

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

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

- (1) Documents (such as business plans and strategies), records, and internal control manuals.
- (2) Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of director's meetings)
- (3) The entity's premises and plant facilities.

RTP MAY 20

Ques-4 Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples.

Ans. Examples are:

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

MTP MARCH 21

Ques-5 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.

Ans. 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.

RTP NOV 20

Ques-6 Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.

Explain with the help of examples.

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

Examples

- Inquiries directed towards those charged with governance may help the auditor understand the environment in which the financial statements are prepared.
- Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.
- Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract terms.
- Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- Inquiries directed to the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system-related risks.

RTP NOV 20

Ques-7 Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Explain in detail.

Ans. Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.

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

However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.

RTP MAY 21

Ques-8 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.

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

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

(b) The nature of the entity, including:

(i) its operations;

(ii) its ownership and governance structures;

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

(iv) the way that the entity is structured and how it is financed;

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

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

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

(e) The measurement and review of the entity's financial performance.

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

RTP MAY 21

Ques-9 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.

Ans. When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

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

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

RTP NOV 21

Ques-10 Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.

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

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

EXAM NOV 22

Ques-11 ABC Ltd. has many divisions and branches across the country. They have an internal control system which is well established and maintained by the management on a regular basis. Explain the meaning of internal control as per SA - 315 and also state the benefits of understanding the internal controls of a company.

Ans. **Meaning and benefits of understanding Internal Control:**

Meaning of Internal Control: As per SA-315, "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", the internal control may be defined as "the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control."

Benefits of Understanding of 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.

RTP MAY 20, RTP NOV 20

Ques-12 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.

Ans. 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.

RTP NOV 21

Ques-13 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.

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

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.

MTP SEPT 2022

Ques-14 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.

Ans: For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:

- (i) 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;
- (ii) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- (iii) 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
- (iv) 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.

MTP SEPT 2022

Ques-15 The risk assessment procedures shall include the inquires of management and of others within the entity who in the auditor's judgement may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. Explain giving at least three examples.

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

Examples

- ◆ Inquiries directed towards those charged with governance may help the auditor understand the environment in which the financial statements are prepared.
- ◆ Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.
- ◆ Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- ◆ Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract terms.
- ◆ Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- ◆ Inquiries directed to the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- ◆ Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system- related risks.

MTP OCT 2022

Ques-16 In exercising judgement as to which risks are significant risks. The auditor shall consider various factors. Explain.

Ans: 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.

EXAM MAY 2023

Ques-17 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?

Ans: 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 of the entity or that otherwise appear to be unusual.

EXAM MAY 2023

Ques-18 Management is often in the best position to perpetrate fraud. As an auditor you are suspecting existence or suspicion of fraud from management. Give any three examples of "others within the entity" to whom direct inquiries can be made.

Ans: **Examples of others within the entity** to whom the auditor may direct inquiries about the existence or suspicion of fraud include:

1. Operating personnel not directly involved in the financial reporting process.
2. Employees with different levels of authority.
3. Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
4. In-house legal counsel.
5. Chief ethics officer or equivalent person.
6. The person or persons charged with dealing with allegations of fraud.

RTP NOV 2023

Ques-19 Obtaining an understanding of the entity and its environment establishes a frame of reference within which the auditor plans the audit and exercises professional judgement throughout the audit. Explain by giving examples.

Ans: Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. This understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

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

RTP NOV 2023

Ques-20 Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware. Explain

Ans: Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.

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

However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.

SA-320

STUDY MATERIAL NEW

Ques-1 Is materiality required to be documented by the auditor? What factors have to be considered this regard?

Ans. The audit documentation shall include the following amounts and the factors considered in their determination:

- (a) Materiality for the financial statements as a whole
- (b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures
- (c) Performance materiality and
- (d) Any revision of (a)-(c) as the audit progressed

STUDY MATERIAL

Ques-2 "Determining materiality involves the exercise of professional judgment". Discuss stating the factors that may affect the identification of an appropriate benchmark. Also give example.

Ans. "Determining materiality involves the exercise of professional judgment". A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements: Assets, liabilities, equity, revenue, expenses;
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates; The entity's ownership structure and the way it is financed and
- The relative volatility of the benchmark.

STUDY MATERIAL

Ques-3 Whether misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements? Explain with examples

Ans. When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

Performance Materiality defined : Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

STUDY MATERIAL, MTP MAY 20, RTP NOV 20, RTP NOV 21

Ques-4 The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain giving examples.

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

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

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

Example

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

5. The capabilities and competence of the individual team members performing the audit work.

Example

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

RTP MAY 21 / PYQ NOV 2023

Ques-5 The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, explain the auditor's assumptions about users of the financial statements.

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

- (i) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- (ii) Understand that financial statements are prepared, presented and audited to levels of materiality;
- (iii) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
- (iv) Make reasonable economic decisions on the basis of the information in the financial statements.

RTP MAY 21

Ques-6 Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Explain

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

1. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
2. Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
3. Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

RTP NOV 21

Ques-7 What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation. Explain

Ans. 5. Materiality is an important consideration for an auditor to evaluate whether the financial statements reflect a true and fair view or not. SA 320 on "Materiality in Planning and Performing an Audit" requires that an auditor should consider materiality and its relationship with audit risk while conducting an audit. When planning the audit, the auditor considers what would make the financial information materially misstated. The auditor's preliminary assessment of materiality related to specific account balances and classes of transactions helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk. It may be noted that the auditor's assessment of materiality and audit risk may be different at the time of initially planning of the audit as against at the time of evaluating the results of audit procedures.

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

RTP MAY 22

Ques-8 You are being appointed as the auditor of Track Ltd. for the first time. You want to determine the materiality level and for that you have applied percentage to choose benchmark as a starting point in determining materiality for the financial statements as a whole. What are the factors that may affect the identification of an appropriate benchmark?

Ans. SA 320 "Materiality in Planning and Performing an Audit" prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

- i. The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- ii. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance, users may tend to focus on profit, revenue or net assets);
- iii. The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates.
- iv. The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- v. The relative volatility of the bench.

EXAM MAY 23

Ques-9 An auditor has to exercise professional judgement in determining materiality. Explain the factors that may affect the identification of an appropriate benchmark in determining materiality for the financial statements as whole.

Ans: Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole: Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

1. The elements of the financial statements

Example

Assets, liabilities, equity, revenue, expenses;

2. Whether there are items on which the attention of the users of the particular entity's financial statements tend to be focused.

Example

For the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets.

3. The nature of the entity where the entity is at in its life cycle and the industry and economic environment in which the entity operates. The entity's ownership structure and the way it is financed.

Example

If an entity is financed solely by debt rather than equity, users may put more emphasis on assets and claims on them than on the entity's earnings.

4. The relative volatility of the benchmark.

PYQ NOV 2023

Ques-10 The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, what are the assumptions that an auditor reasonably makes in respect of the users of the financial statements?

SA-450

STUDY MATERIAL NEW

Ques-1 Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450.

Ans: **The audit documentation shall include: -**

- (a) The amount below which misstatements would be regarded as clearly trivial;
- (b) All misstatements accumulated during the audit and whether they have been corrected; and
- (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

SA-500

STUDY MATERIAL NEW

Ques-1 Discuss what is understood by "appropriateness" of audit evidence.

Ans. The sufficiency and appropriateness of audit evidence are interrelated.

Sufficiency is the measure of the **quantity of audit evidence**.

The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required)

Appropriateness is the measure of the **quality of audit evidence**; that is, its **relevance and its reliability** in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and nature, and is dependent on the individual circumstances under which it is obtained.

STUDY MATERIAL NEW

Ques-2 Maintaining accounts using accounting software having a feature of recording audit trail can be useful for an auditor. Discuss some of the advantages for such a feature in accounting software for auditors.

- ✦ An audit trail is a documented flow of a transaction. It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity.
- ✦ It is used as audit evidence to establish authentication and integrity of a transaction.
- ✦ Audit trails help in maintaining record of system and user activity. Like, in case of banks, there is an audit trail keeping track of log-on activity detailing record of log-on attempts and device used.
- ✦ It is a step-by-step record by which accounting, trade details, or other financial data can be traced to their source.
- ✦ Audit trails are used to verify and track many types of transactions including accounting and financial transactions.
- ✦ Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use.
- ✦ Audit trails help to enhance internal controls and data security.
- ✦ Audit trails can help in fixing responsibility, rebuilding events and in thorough analysis of problem areas
- ✦ Audit trail analysis can specify reason of the problem. It can also help in ensuring operation of system as intended. In this way, audit trails can help entities in their regular system operations.

However, audit trails involve costs. The cost is not only in terms of system expenditure but also in terms of time involved in analysing data made available by audit trails. However, use of automated tools can be made to analyse large volume of data thrown up by audit trails

STUDY MATERIAL NEW

Ques-3 Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain

Ans. 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.

STUDY MATERIAL NEW

Ques-4 What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor's judgement as to the sufficiency of audit evidence.

Ans. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

Following are the factors affecting the auditor's judgement as to the sufficiency of audit evidence:

(a) Materiality: It may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.

(b) Risk of material misstatement: It may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level:

- ✦ **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.

- ✦ **Control risk**—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.

Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.

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

STUDY MATERIAL NEW

Ques-5 An auditor is appointed for the first time for audit of accounts of an entity. The accounts of previous year were unaudited. He is unable to obtain sufficient appropriate audit evidence regarding the opening balances. What is his responsibility in this regard?

Ans: 1. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

2. If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

RTP MAY 19

Ques-6 The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence,

however, may not compensate for its poor quality. Analyse and Explain stating clearly the factors affecting the auditor's judgement as to sufficiency of audit evidence.

Ans. Sufficiency of Audit Evidence: Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Auditor's judgment as to sufficiency may be affected by the factors such as:

- (i) Materiality
- (ii) Risk of material misstatement
- (iii) Size and characteristics of the population.

(i) Materiality may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.

(ii) Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level

(a) **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.

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

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

RTP NOV 19

Ques-7 (a) 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 detailed meaning of audit evidence.

(b) 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

Ans. (a) 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.

(b) 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.

RTP MAY 20

Ques-8 Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques.

Analyse and explain with the help of example of evidence in respect of Sales.

Ans. Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques. What is best evidence for testing the accuracy of any assertion is a matter of expert knowledge and experience. This is the primary task before the auditor when he draws up the audit programme. Transactions are varied in nature and impact; procedures to be prescribed depend on prior knowledge of what evidence is reasonably available in respect of each transaction.

Example

Sales are evidenced by:

- (i) invoices raised by the client;
- (ii) price list;
- (iii) forwarding notes to client;
- (iv) inventory-issue records;
- (v) sales managers' advice to the inventory section;
- (vi) acknowledgements of the receipt of goods by the customers; and
- (vii) collection of money against sales by the client

RTP NOV 20

Ques-9 Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement and also by the quality of such audit evidence.

Obtaining more audit evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgment as to sufficiency of audit evidence.

Ans. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Auditor's judgement as to sufficiency may be affected by the factors such as:

(i) Materiality

(ii) Risk of material misstatement

(iii) Size and characteristics of the population.

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

(2) Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of

two components described as follows at the assertion level

(a) **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.

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

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

MTP MARCH 22

Ques-10 The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source, its nature and the circumstances under which it is obtained. Explain and elucidate the guiding principles which are useful in assessing the reliability of audit evidence

Ans. Reliability of Audit Evidence: As per SA 500 on "Audit Evidence", the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions.

While recognizing that exceptions may exist, the following guiding principles about the reliability of audit evidence may be useful:

(i) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

(ii) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

(iii) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

(iv) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).

(v) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance

MTP OCT 22

Ques-11 CA Amar is the statutory auditor of XYZ Ltd. For the FY 2021-22. During the course of audit CA Amar found that a litigation is going against the company for which the company has hired an external legal team (management expert). CA Amar wanted to use the information as audit evidence which is prepared using the work of the management expert. What should CA Amar consider before using the work of such management expert ?

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

1. Evaluate the competence, capabilities and objectivity of that expert;
2. Obtain an understanding of the work of that expert; and
3. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.
4. CA Amar should consider the above before using the work of the management's expert.

RTP MAY 22

Ques-12 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.

Ans. 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. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

(ii) 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, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

(iii) 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.

(iv) In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

EXAM NOV 2022

Ques-13 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 audit procedures the auditor can perform to obtain audit evidence ?

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

(I) Risk assessment procedures; and

(II) 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

MTP APRIL 2023

Ques-14 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.

Ans. 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.

MTP APRIL 2023

Ques-15 What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor's judgement as to the sufficiency of audit evidence.

Ans. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

Following are the factors affecting the auditor's judgement as to the sufficiency of audit evidence:

(i) Materiality: It may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand, if assertions are more material to the users of the financial statements, more evidence would be required.

(ii) Risk of material misstatement: It may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level:

Inherent risk—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.

Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.

Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.

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

RTP NOV 2023

Ques-16 T Ltd has used the services of an expert for the purpose of physical verification of its inventory which is appearing in the financial statements of the company at Rs 75 Crores. Discuss the broad parameters auditor would take into consideration while deciding about using the work performed by the Management's Expert in physical verification of company's inventory.

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

- (a) Evaluate the competence, capabilities and objectivity of that expert;
- (b) Obtain an understanding of the work of that expert; and
- (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

PYQ NOV 2023

Ques-17 You are the senior member of the engagement team of m/s BB & associates. Before starting the audit, you explained to other junior assistants about the meaning of audit evidence. One of the junior assistant is of the view that audit evidence includes only information contained in the accounting records and no other information. You are of the opinion that a combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial Statements. In the above context illustrate with two appropriate examples of each:

- i) information contained in the accounting records.
- ii) Other information that authenticates the accounting records.

PYQ NOV 2023

Ques-18 Sales invoice is an example of external evidence.

SA-501

STUDY MATERIAL NEW

Ques-1 Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

Ans: **Matters relevant in planning attendance at physical inventory counting include, for example:**

- (a) Nature of inventory.
- (b) Stages of completion of work in progress.
- (c) The risks of material misstatement related to inventory.
- (d) The nature of the internal control related to inventory.
- (e) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- (f) The timing of physical inventory counting.
- (g) Whether the entity maintains a perpetual inventory system.
- (h) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate.
- (i) Whether the assistance of an auditor's expert is needed.

MTP MARCH 21

Ques-2 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.

- (a) 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.

RTP MARCH 2022

Ques-3 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.

Ans. 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.

SA-505

STUDY MATERIAL NEW

Ques-1 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.

Ans. 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.

PYQ JULY 2021

Ques-2 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.

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

- (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions,
- (c) A very low exception rate is expected; and
- (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

RTP MAY 20

Ques-3 (a) Define the following :

- (i) Positive confirmation request
- (ii) Negative confirmation request
- (iii) Non-response
- (iv) Exception

(b) Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

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

Negative confirmation request - A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

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

Exception - A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

(b) Matters relevant in planning attendance at physical inventory counting include, for example:

- (a) Nature of inventory.
- (b) Stages of completion of work in progress.
- (c) The risks of material misstatement related to inventory.
- (d) The nature of the internal control related to inventory.
- (e) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- (f) The timing of physical inventory counting.
- (g) Whether the entity maintains a perpetual inventory system.
- (h) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
- (i) Whether the assistance of an auditor's expert is needed.

MTP APRIL 2022

Ques-4 External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. Apart from confirmations for bank balances and accounts receivables, what are the other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement?

Ans. Other examples of situations where external confirmations may be used include the following:

Inventories held by third parties at bonded warehouses for processing or on consignment

Property title deeds held by lawyers or financiers for safe custody or as security

Investments held for safekeeping by third parties, or purchases from stockbrokers but not delivered at the balance sheet date

Amounts due to lenders, including relevant terms of repayment and restrictive covenants.

Accounts payable balances and terms Long outstanding share application money.

EXAM MAY 23

Ques-5 CA P is the auditor of MN Ltd. While scrutinizing the accounts of MN Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31 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.

Ans: **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 here under:**

(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.

SA-510

STUDY MATERIAL NEW

Ques-1 An auditor is appointed for the first time for audit of accounts of an entity. The accounts of previous year were unaudited. He is unable to obtain sufficient appropriate audit evidence regarding the opening balances. What is his responsibility in this regard?

Ans. Reporting by the auditor with regard to opening balances

1. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.
2. If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

STUDY MATERIAL NEW

Ques-2 Discuss the objective of Auditor with respect to Opening balances in conducting an initial audit engagement.

Ans. Objective of Auditor with respect to Opening Balances-in conducting an Initial Audit Engagement

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.

STUDY MATERIAL NEW

Ques-3 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?

Ans. 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.

STUDY MATERIAL NEW

Ques-4 M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2022-23-. 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?

Ans. As per SA 510, "Initial Engagement- Opening balances" the objective of the auditor with respect to the opening balances is to obtain sufficient and 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.

EXAM MAY 2022, MTP APRIL 2023

Ques-5 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?

OR

The newly appointed auditor of Parag 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?

Ans. **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.

SA-520

STUDY MATERIAL NEW

Ques-1 Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit.

Ans. Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

Analytical Procedures in Planning the Audit

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions.

STUDY MATERIAL NEW

Ques-2 While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence?

Ans. While applying the Substantive Analytical Procedures the statutory auditor of a company may use the following techniques to obtain sufficient and appropriate audit evidence

Trend analysis - Trend analysis is a commonly used technique. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Ratio analysis - Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

Reasonableness tests - Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. In other words these tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts.

Structural modelling - A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

The statutory auditor may use any of the above mentioned techniques while applying substantive analytical procedures depending upon the availability of data and requirements of the case.

STUDY MATERIAL NEW

Ques-3 The statutory auditor of MNO Ltd., CA Kishore identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of MNO Ltd. What should CA Kishore do in this case with reference to SA 520 on "Analytical Procedures"?

Ans. As per SA 520- "Analytical Procedures" If while applying analytical procedures in accordance with SA 520, the statutory auditor identifies fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses: Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

(ii) Performing other audit procedures as necessary in the circumstances: The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate. In the present case, CA Kishore identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of MNO Ltd. CA Kishore should inquire the management of MNO Ltd. and obtain sufficient and appropriate audit evidence relevant to management response. Further, CA Kishore should also perform other audit procedures if required in the circumstances of the case to obtain further sufficient and appropriate audit evidence.

STUDY MATERIAL NEW

Ques-4 What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA-520 on "Analytical procedures".

Ans. The following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures:

- i. Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.
- ii. Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.
- iii. Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved.
- iv. Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

STUDY MATERIAL NEW

Ques-5 Define Analytical Procedures.

Ans. 16. Meaning of Analytical Procedures: As per the Standard on Auditing (SA)

520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.

PYQ JAN 2021

Ques-6 Explain the techniques available as Substantive Analytical procedures.

Ans: **Techniques Available as Substantive Analytical Procedures**

The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms:

Trend analysis - A commonly used technique is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Ratio analysis - Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be

compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

Reasonableness tests - Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts.

Structural modelling- A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

RTP MAY 19, EXAM JULY 21, RTP MAY 2022, RTP MAY 2023

Ques-7 If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, explain how the auditor would investigate such differences.

OR

The statutory auditor of ABC Ltd., CA Raj identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of ABC Ltd. With reference to SA 520 on "Analytical Procedures", how CA Raj shall investigate such differences?

Ans. If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses: Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

(ii) Performing other audit procedures as necessary in the circumstances: The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

Conclusion: In the present case CA Raj identifies certain inconsistencies while applying analytical procedure to financial or non-financial data of ABC Ltd. CA Raj should inquire the management of ABC Ltd, and obtain sufficient and appropriate audit evidences relevant to the management response. Further CA Raj should also perform other audit procedures, if required in the circumstances of the case to obtain further sufficient and appropriate evidence.

RTP NOV 19

Ques-8 Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and explain stating clearly the meaning of analytical procedures.

Ans Since routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests. These collectively are known as overall tests. With the passage of tests, analytical procedures have acquired lot of significance as substantive audit procedure. SA-520 on Analytical Procedures discusses the application of analytical procedures during an audit. Meaning of Analytical Procedures. As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

RTP NOV 19

Ques-9 Give examples of Analytical Procedures having consideration of comparisons of the Entity's financial information

Ans. Examples of Analytical Procedures having consideration of comparisons of the entity's financial information with are:

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

EXAM NOV 19

Ques-10 CA A, auditor of ABC Ltd. Wants to design substantive analytical procedure and for that he wants to check whether the data is reliable or not. Mention the relevant points which he has to consider whether data is reliable for purpose of designing the substantive analytical procedures.

Ans. The following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures:

- i. Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.
- ii. Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.
- iii. Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved.
- iv. Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

RTP MAY 20

Ques-11 Explain the commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances.

Ans. **Trend analysis** - A commonly used technique is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

RTP MAY 20

Ques-12 When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context.

Ans. When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:

- (i) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
- (ii) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
- (iii) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and

(iv) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

RTP NOV 20

Ques-13 In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk. Explain

Ans. In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

RTP NOV 20

Ques-14 The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment. Explain

Ans. The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.

EXAM NOV 20

Ques-15 With respect to SA 520 "Analytical procedures". Explain the following factors to be considered by the auditor for substantive audit procedures.

- (i) Account type
- (ii) Predictability
- (iii) Nature of Assertion.

Ans. The auditor should consider the following factors for Substantive Audit Procedures:

Account Type - Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment.

Predictability - Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time.

Nature of Assertion - Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/ measurement and occurrence.

MTP APRIL 21

Ques-16 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.?

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.

RTP MAY 21, MTP OCTOBER 21

Ques-17 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

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

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

RTP NOV 21

Ques-18 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.

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

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

Analytical procedures also include consideration of relationships, for example:

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

RTP NOV 21

Ques-19 Analysis by computation of ratios includes the study of relationships between financial statement amounts. State Commonly used ratios

Ans. Analysis by computation of ratios includes the study of relationships between financial statement amounts. Commonly used ratios include:

- Elements of income or loss as a percentage of sales
- Gross profit turnover
- Accounts receivable turnover
- Inventory turnover
- Profitability, leverage, and liquidity

MTP APRIL 2022

Ques-20 Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain

Ans. **Substantive Analytical Procedure:** Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

RTP MAY 2022

Ques-21 Discuss the matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated.

Ans. **Substantive Analytical Procedure:** Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

EXAM MAY 2022

Ques-22 Tree Limited presented its financial statements for the F.Y. 2021-2022 to its auditor for expressing an opinion there on. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons?

Ans. **Purpose of Applying Analytical Procedure:** Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable.

The auditor of Tree Ltd. would achieve the following by carrying out the comparison stated in the question:

- (i) If balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years.
- (ii) By setting up certain expenses' ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales.
- (iii) If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.
- (iv) It would be possible to identify the existence of unusual transactions, amounts, ratios and trends that might indicate matters that have audit implications.

EXAM NOV 2022

Ques-23 As per the Standard on Auditing (SA) 520 "Analytical Procedures", 3 what are the examples of analytical procedures having consideration of relationships?

Ans. Examples of Analytical Procedure having consideration of relationship:

As per the Standard on Auditing (SA) 520 "Analytical Procedures", examples of Analytical Procedures having consideration of relationships are:

- i. 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.
- ii. Between financial information and relevant non-financial information, such as payroll costs to number of employees.

EXAM MAY 2023

Ques-24 The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Explain the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures.

Ans: **The reliability of data** is influenced by its source and nature and is dependent on the circumstances under which it is obtained.

Accordingly, the following points are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

- (i) Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.
- (ii) Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;
- (iii) Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved, and
- (iv) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

RTP NOV 2023

Ques-25 SA 500- "Audit Evidence", explains that constitutes audit evidence in an audit of financial statements. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements. Explain and discuss the meaning of Audit Evidence in detail.

Ans: SA 500 - "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

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.

RTP NOV 2023

Ques-26 Flower Limited presented its financial statements for the F.Y. 2022-2023 to its auditor for expressing an opinion thereon. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons ?

Ans: Purpose of Applying Analytical Procedure: Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable.

The auditor of Flower Ltd. would achieve the following by carrying out the comparison stated in the question:

- (i) If balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years.
- (ii) By setting up certain expenses' ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales.
- (iii) If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.
- (iv) It would be possible to identify the existence of unusual transactions, amounts, ratios and trends that might indicate matters that have audit implications.

PYQ NOV 2023

Ques-27 While conducting the audit of PDP Ltd. For the financial year 2022-23, the statutory auditor identified certain inconsistencies while applying analytical procedures to the financial and non-financial data of PDP Ltd. Can statutory auditor investigate results of Analytical Procedures duly performed in accordance with SA 520 ? Discuss.

SA-530

STUDY MATERIAL NEW

Ques-1 What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling".

Ans. Meaning of Audit Sampling: "Audit Sampling" means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

Refer to heading "Samples Selection methods".

STUDY MATERIAL NEW

Ques-2 With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing.

Ans. Audit Sampling: As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is - the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The requirements relating to sample design, sample size and selection of items for testing are explained below-
Sample design - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.

Sample Size- The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

Selection of Items for Testing- The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

STUDY MATERIAL NEW

Ques-3 While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?

Ans. Risk Factors while applying Sampling Techniques: As per SA 530 "Audit Sampling", 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. Sampling risk can lead to two types of erroneous conclusions-

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

STUDY MATERIAL NEW

Ques-4 Write short notes on the following:

(a) Advantages of Statistical sampling in Auditing.

(b) Stratified sampling

(a) The advantages of statistical sampling may be summarized as follows -

(1) The amount of testing (sample size) does not increase in proportion to the increase in the 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.

(b) Stratified Sampling: This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.

STUDY MATERIAL NEW

Ques-5 What precautions should be taken by the auditor while applying test check techniques?

Ans. Precautions to be taken while applying test check techniques are

- Thorough study of accounting system should be done before adopting sampling.
- Proper study of internal control systems.
- Areas which are not suitable for sampling should be carefully considered. Eg: compliance with statutory provisions, transactions of unusual nature etc.
- Proper planning for Sampling methods to be used and explaining the staff,
- Transactions and balances have to be properly classified (stratified)
- Sample size should be appropriately determined.
- Sample should be chosen in unbiased way,
- Errors located in the sample should be analysed properly.

STUDY MATERIAL NEW

Ques-6 Explain the factors to be considered while determining the extent of checking on a sampling plan.

Ans. The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

- (i) Size of the organisation under audit.
- (ii) State of the internal control.
- (iii) Adequacy and reliability of books and records.
- (iv) Tolerable error range.
- (v) Degree of the desired confidence.

PYQ NOV 2018

Ques-7 Discuss the following: Factors that should be considered for deciding upon the extent of checking on a sampling plan.

Ans: The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

- i) Size of the organization under audit
- ii) State of the internal control
- iii) Adequacy and reliability of books and records
- iv) Tolerable error range
- v) Degree of the desired confidence

PYQ JAN 2021

Ques-8 In the context of SA 530 'Audit Sampling', explain the terms 'Sampling Risk' and 'Non- Sampling risk'.

Ans: Sampling Risk. 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 Sampling risk can lead to two types of erroneous conclusions:

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-Sampling Risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk

Example

Examples of non-sampling risk include use of inappropriate audit procedures; or misinterpretation of audit evidence and failure to recognize a misstatement or deviation

Sources of Non Sampling risk are:

- (i) Human Mistakes
- (ii) Applying audit procedures not appropriate to the objectives of audit
- (iii) Relying on erroneous information eg. erroneous confirmation
- (iv) Misinterpreting the sample results

Non sampling risk can never be mathematically measured.

RTP MAY 19

Ques-9 The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain

Ans. 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. 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.

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.

RTP NOV 19, MTP APRIL 2022

Ques-10 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

Ans. 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.

RTP NOV 19

Ques-11 The extent of the checking to be undertaken is primarily a matter of judgment of the auditor. It is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed Explain

Ans. The extent of the checking to be undertaken is primarily a matter of judgment of the auditor, there is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent. It is also not obligatory that the auditor must adopt the sampling technique. What he is to do is to express his opinion and become bound by that.

To ensure good and reasonable standard of work, he should adopt standards and techniques that can lead him to an informed professional opinion. On a consideration of this fact, it can be said that it is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed and which have a recognised basis. Since statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability.

RTP MAY 20

Ques-12 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. Explain

Ans. 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. 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. 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.

RTP MAY 20

Ques-13 Explain the sampling method which involves selection of a block(s) of contiguous items from within the population. Also give example.

Ans. 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.

MTP MAY 20

Ques-14 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 (any four) that the auditor may consider when determining the sample size for tests of controls.

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.

MTP OCTOBER 20

Ques-15 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. 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. 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.

The advantages of statistical sampling may be summarized as follows -

- (1) The amount of testing (sample size) does not increase in proportion to the increase in the 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.

EXAM NOV 20

Ques-16 It's us imperative for the auditor to project misstatements for the population while performing audit procedures through sampling comments

- Ans. (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.

RTP NOV 20, EXAM JAN 21

Ques-17 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. Sampling risk leads to erroneous conclusions. Explain in detail distinguishing it from non-sampling risk with examples.

OR

In the context of SA 530 'Audit Sampling', explain the terms 'Sampling Risk' and 'Non-Sampling risk'

Ans. Sampling Risk. 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. Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-Sampling Risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.

Sources of Non Sampling risk are :

- (i) Human Mistakes
- (ii) Applying audit procedures not appropriate to the objectives of audit
- (iii) Relying on erroneous information e.g. erroneous confirmation
- (iv) Mis-interpreting the sample results
- (v) Non sampling risk can never be mathematically measured.

RTP APRIL 21, EXAM MAY 19

Ques-18 Sampling risk can lead to erroneous conclusions". Justify.

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. Sampling risk can lead to two types of erroneous conclusions:

- i. In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- ii. In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

RTP MAY 21

Ques-19 Explain the following terms with reference to Audit Sampling :

- (i) Stratification
- (ii) Tolerable misstatement
- (iii) Tolerable rate of deviation

Ans. (i) **Stratification** - The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

(ii) **Tolerable misstatement** - A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

(iii) **Tolerable rate of deviation** - A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

RTP MAY 21

Ques-20 In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries. Explain in detail.

Ans. In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries.

Auditors realised that they can derive good satisfaction by undertaking a much lesser checking by adoption of this technique in the auditing process. It is a mathematical truth that the sample, if picked purely on a random basis would reveal the features and characteristics of the population.

By adopting the sampling technique, the auditor only checks a part of the whole mass of transactions. The satisfaction he used to derive earlier, by checking all the transactions, can be derived by a sample checking provided he can put reliance on the internal controls and checks within the client's organisation because they provide the reliability of the records. Sampling is used as a part of Test of controls. Auditor will check few internal controls and their operating effectiveness. Based on the conclusion derived, he can then design the sample size for test of details (i.e checking of transactions and balances)

If the internal control is satisfactory in its design and implementation, a much smaller sample can give the auditor the necessary reliability of the result he obtains.

On the other hand, if in certain areas controls are slack or not properly implemented, the auditor may have to take a much larger sample for getting satisfactory result.

Another truth about the sampling technique should be noted. It can never bring complete reliability; it cannot give precisely accurate results. It is a process of estimation. It may have some error. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular case.

RTP NOV 21

Ques-21 When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. Explain in detail.

Ans. Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling. In fulfilling the requirement of relevant portion (paragraph 8) of SA 500, when performing audit sampling, the auditor performs audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.

The auditor's consideration of the purpose of the audit procedure includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the purpose of the audit procedure are included in the evaluation of deviations or projection of misstatements. For example, in a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after that date by the client, are not considered a misstatement. Also, a misposting between customer accounts does not affect the total accounts receivable balance. Therefore, it may not be appropriate to consider this a misstatement in evaluating the sample results of this particular audit procedure, even though it may have an important effect on other areas of the audit, such as the assessment of the risk of fraud or the adequacy of the allowance for doubtful accounts.

In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the relevant controls or on the examination of a small number of items from the population. This assessment is made in order to design an audit sample and to determine sample size. For example, if the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100% examination or use of a large sample size may be appropriate when performing tests of details.

In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

RTP NOV 21

Ques-22 In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. Guide the auditor on the use of stratification and value-weighted sampling techniques.

Ans. In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques.

Stratification: Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic.

The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement.

Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.

Dividing a population into discrete sub population which have identifying characteristics is called as Stratification. Each Sub population is called as Stratum and units under those sub population are referred to as Strata.

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

The results of samples from the units drawn under each sub population are projected to that respective stratum. In order to draw an opinion on the overall population, the auditor needs to combine the results of all the stratum to check for possible deviation or risk of material misstatement.

Projected misstatements of each stratum will be combined together to consider the possible effect of misstatement in the account balances and class of transactions.

Example

20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).

Value-Weighted Selection: When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units.

One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes.

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

In value weighted selection, the sample size, its selection and evaluation will result in a conclusion in monetary amounts.

MTP NOV 21

Ques-23 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.

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

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

Advantages of Statistical Sampling in 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.

EXAM DEC 21

Ques-24 With reference to SA 530 "Audit Sampling", explain briefly the following factors that the auditor may consider when determining the sample size for the Test of Details -

- (i) The desired level of assurance
- (ii) Stratification of the population.

Ans. Examples of factors influencing Sample Size for Test of Details:

(i) Desired Level of Assurance: An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.

(ii) Stratification of population: When stratification of the population is appropriate then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.

MTP MARCH 2022

Ques-25 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

Ans. 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

RTP MAY 2022

Ques-26 What are the advantages of Statistical sampling technique in auditing?

Ans. Advantages of Statistical Sampling in Auditing: The advantages of statistical sampling may be summarized as follows -

- (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.

RTP MAY 2022

Ques-27 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

Ans. 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

RTP MAY 2022

Ques-28 Sampling risk can lead to two types of erroneous conclusions. Explain clearly stating the meaning of sampling risk

Ans. Sampling Risk. 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. This risk will always be in existence when auditor uses sampling technique in conducting his audit.

Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. This is because of over reliance on the internal controls.
- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect. This is because of under reliance on the test of controls and detailed substantive procedures performed by the auditor. Here risk of giving wrong opinion is minimum but it will lead to more detailed checking which is time consuming.

EXAM MAY 2022

Ques-29 The approach to audit and extent of checking are undergoing a progressive change in favours of more attention towards the questions of principle and controls with a curtailment of non - consequential routine checking. Discuss the given statement.

Ans. Sampling: An Audit Procedure: 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 the efforts are directed to check all transactions without any 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 i.e., the internal controls as designed by the management are for the very purpose of Prevention, Detection and Correction of Frauds and Errors. Thus, the 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 the entries, disregarding the concept of materiality.

The extent of the checking to be undertaken is primarily a matter of judgment of the auditor. There is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent it has to be done. It is also not obligatory that the auditor must adopt the sampling technique. What he is to do as an auditor is to express his opinion on the financial statements and become bound by that.

To ensure good and reasonable standard of work, he should adopt standards and techniques that can lead him to an informed professional opinion. On consideration of this fact, it can be said that it is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking (i.e., sampling), he should adopt standards and techniques which are widely followed and which have a recognised basis.

Since statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability. This enables the auditor to make conclusions and express fair opinion without having to check all of the items within the financial statements.

EXAM NOV 2022

Ques-30 What are the matters that the auditor shall consider while designing an audit sample ?

Ans. Matters to be considered while designing an Audit Sample:

As per SA 530, "Audit Sampling",

- (i) When designing an audit sample, the auditor shall consider the purpose of the audit procedures and the characteristics of the population from which the sample will be drawn.
- (ii) When designing an audit sample, the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
- (iii) When designing an audit sample, the auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.
- (iv) When designing an audit sample, the auditor shall determine that sample selected must be representative of the population.
- (v) When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.
- (vi) When designing an audit sample, Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling.
- (vii) In fulfilling the requirement of SA 500 "Audit Evidence", when performing audit sampling, the auditor performs audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.

Ques-31 Random selection ensures that all items in the population or within each stratum have a known chance of selection. Random sampling includes two very popular methods. Explain.

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

(i) Simple Random Sampling: Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. It is considered that random number tables are simple and easy to use and also provide assurance that the auditors' bias does not affect the selection. Each item in a population is selected by use of random number table either with a help of computer or picking up a number in a random way (may be randomly from a drum). Today random numbers are also generated using various applications on the cell phones like the random number generator.

This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e it is suitable for a homogeneous population having a similar range.

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

EXAM MAY 2023

Ques-32 While designing an audit sample, the auditor shall determine a sample size sufficient to reduce the sampling risk to an acceptably low level. In this context, explain sampling risk and non-sampling risk.

Ans. Risk Factors while applying Sampling Techniques: As per SA 530 "Audit Sampling", 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. Sampling risk can lead to two types of erroneous conclusions-

(i) In the case of a test of controls, that controls are m

ore effective than they actually are, or in the case of tests of details, that a material misstatement does not exists when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatements exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

RTP NOV 2023

Ques-33 Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Ans: The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

RTP NOV 2023

Ques-34 Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2022-2023.

Chintan & Mani seem to have different opinion on audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population.

Chintan is concerned whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530

Ans: As per SA 530, "Audit Sampling", the auditor shall evaluate:

- (a) The results of the sample; and
- (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

- (I) Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
- (II) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

PYQ NOV 2023

Ques-35 Block sampling does not involve judgement, does not even use the random number tables and has no structured approach.

PYQ NOV 2023

Ques-36 Mention any four factors that should be considered for deciding upon the extent of checking on sampling plan.

PYQ NOV 2023

Ques-37 Mention any four samples that should be considered for deciding upon the extent of checking on sampling plan

SA-550

STUDY MATERIAL NEW

Ques-1 Many related party transactions are in the normal course of business. 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. Give few examples of such areas.

Ans. 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

FOR EXAMPLE

(A) 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.

(B) Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.

(C) 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.

STUDY MATERIAL NEW

Ques-2 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.

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

Example

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

You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530

Ans: As per SA 530, "Audit Sampling", the auditor shall evaluate:

- (a) The results of the sample; and
- (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

- (I) Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
- (II) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

PYQ NOV 2023

Ques-35 Block sampling does not involve judgement, does not even use the random number tables and has no structured approach.

PYQ NOV 2023

Ques-36 Mention any four factors that should be considered for deciding upon the extent of checking on sampling plan.

PYQ NOV 2023

Ques-37 Mention any four samples that should be considered for deciding upon the extent of checking on sampling plan

SA-550

STUDY MATERIAL NEW

Ques-1 Many related party transactions are in the normal course of business. 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. Give few examples of such areas.

Ans. 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

FOR EXAMPLE

(A) 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.

(B) Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.

(C) 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.

STUDY MATERIAL NEW

Ques-2 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.

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

Example

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

SA-560

STUDY MATERIAL NEW

Ques-1 Discuss meaning of "Date the financial statements are issued" under SA 560

Ans: It reflects the date that the auditor's report and audited financial statements are made available to third parties. The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report, but must also be at or later than the date the auditor's report is provided to the entity.

RTP MAY 19

Ques-2 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. Explain.

Ans. Audit Procedure Regarding Events Occurring Between the Date Of The Financial Statements and the Date of the Auditor's Report

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.

RTP MAY 20, MTP NOV 21

Ques-3 The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation.

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

- (a) Discuss the matter with management and, where appropriate, those charged with governance.
- (b) Determine whether the financial statements need amendment and, if so,
- (c) Inquire how management intends to address the matter in the financial statements.

RTP NOV 21

Ques-4 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

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

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

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

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

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

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

SA-570

STUDY MATERIAL NEW

Ques-1 The auditor of a company is having concerns about following of going concern basis of accounting followed by management for preparation of financial statements. It asks the management to justify preparation of financial statements. However, management is not willing to make its assessment and share with auditor. What are implications for auditor's report in such a scenario?

Ans: **Management unwilling to make or extend its assessment**

If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report. In such a situation, a **qualified opinion or a disclaimer of opinion** in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements

PYQ JAN 2021

Ques-2 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 judgment?

Ans: 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.

RTP MAY 19, RTP Nov 19, RTP MAY 21, MTP APRIL 2022

Ques-3 (a) On the basis of which assumption the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern.

Or

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. Explain stating also the objective of the auditor regarding going concern.

Or

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.

Ans. **Going Concern Basis of Accounting**

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. 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.

Objectives of the auditor regarding going concern are :

- (i) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- (ii) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (iii) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor

RTP MAY 21

Ques-4 as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. Explain stating the auditor's responsibilities with regard to going concern.

Ans. **The auditor's responsibilities are:**

- (1) to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and
- (2) to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

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

RTP NOV 21

Ques-5 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

Ans. Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists

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

- (a) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements

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

- (b) Adequate Disclosure of a Material Uncertainty is Not Made in the 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.

RTP MAY 20

Ques-6 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.

Ans. 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.

EXAM MAY 2023

Ques-7 S Ltd., a large textile manufacturing company, due to heavy recession in the market was unable to collect amount of huge receivables in time and also holding large amounts of stock of raw materials and finished goods since last 9 months of the Financial Year 2022-23.

From your primary observations of audit evidences, you feel that there is a material uncertainty exists about going concern.

How will you deal in your audit report?

What will be the effect on your audit opinion in the following situations?

- (i) If adequate disclosure of such material uncertainty is already made in the financial statements.
- (ii) If adequate disclosure of such material uncertainty is not made in the financial statements.

Ans: **The Auditor of S Ltd shall deal in the following manner in his Audit Report:**

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.

(1) 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."

(2) 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.

PYQ MAY 2023

Ques-8 M/s ANS & Associates has been appointed as the statutory auditors of MNO Ltd. The company has been suffering losses due to the emergence of highly successful competitor, thereby leading to negative net worth. Also, the sales head, key management personnel, of the company left the company due to health issues. When CA Amar, the engagement partner discussed the scenario with the management of the company, he did not get any satisfactory reply from the management. What is the responsibility of M/s ANS & Associates with regard to SA 570?

SA-580

PYQ JAN 2021

Ques-1 Explain the objectives of the auditor regarding written representations.

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

(i) To obtain written representations

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

(ii) To support other evidence

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

(iii) To respond appropriately

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

PYQ DEC 2021

Ques-2 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 acknowledgment and understanding of responsibilities in written representation?

Ans: **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:

- (i) Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- (ii) The terms of the audit engagement were prepared in a previous year,
- (iii) There is any indication that management misunderstands those responsibilities, or
- (iv) Changes in circumstances make it appropriate to do so.

RTP May 20, MTP NOV 21

Ques-3 Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation.

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

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

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

evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions. The objectives of the auditor regarding written representation

The objectives of the auditor are:

(a) To obtain written representations

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

(b) To support other evidence

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

(c) 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.

MTP MARCH 2023

Ques-4 Akash & Associates are the statutory auditors of Deluxe Ltd. for the FY 2020 -21. During the course of audit, CA Akash, the engagement partner requested the management of the company to provide written representation with respect to valuation of a transaction. The management, however does not provide the same to CA Akash. What course of action should CA Akash follow in such situation?

Ans. If management of Deluxe Ltd. does not provide one or more of the requested written representations, CA Akash should:

(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 (oral or written) 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.

RTP NOV 2023

Ques-5 Written representations are to be provided by the management to the auditor when requested. Explain

Ans: **Management from Whom Written Representations Requested:** SA-580, "Written Representations", the auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.

Written representations are requested from those responsible for the preparation and presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation and presentation of the financial statements.

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

(i) discuss the matter with management;

(ii) re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and

(iii) take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor shall disclaim an opinion on the financial statements if management does not provide the written representations.

SA-610

STUDY MATERIAL NEW

Ques-1 Discuss some of circumstances when work of the internal auditor cannot be used by external auditor.
 Ans. The external auditor shall not use the work of the internal audit function if the external auditor determines that:

- (a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
- (b) The function lacks sufficient competence; or
- (c) The function does not apply a systematic and disciplined approach, including quality control.

RTP MAY 19

Ques-2 Explain the meaning, objectives and scope of internal audit functions as per SA 610. Also discuss who can be appointed as Internal Auditor?

Ans. 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.
 - (vi) 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.

Chapter - 11

Ethics & Terms of Audit Engagement

STUDY MATERIAL NEW

Ques-1 Briefly outline how principles-based approach differs from rules-based approach to ethics.

Ans: Ethical guidance may follow principles-based approach or rules-based approach. The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise. It requires that accountants should use professional judgment to evaluate every situation to arrive at conclusions.

However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules. Further, rules-based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

Therefore, it is necessary that spirit of code is followed.

STUDY MATERIAL NEW

Ques-2 How application of professional skepticism throughout audit is helpful in reducing audit risk?

Ans: Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:

1. Overlooking unusual circumstances.
2. Over generalising when drawing conclusions from audit observations.
3. Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

STUDY MATERIAL NEW

Ques-3 A Chartered accountant is conducting audit of a client for last two years. Before proceeding to start audit for next year, he notices that there is substantial change in management. Besides, client has ventured into areas of business activity which were not present at time of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210.

Ans: In 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:

- (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.

STUDY MATERIAL NEW

Ques-4 How does SQC 1 ensure that independence in engagements is not breached by an audit firm?

Ans: Observance of "Independence" in all engagements is the basic requirement. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and

(including experts contracted by the firm and network firm personnel) maintain independence where required by the Code. Such policies and procedures should enable the firm to: -

- (a) Communicate its independence requirements to its personnel
- (b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

There should exist a mechanism in the firm by which engagement partners provide the firm with relevant information about client engagements and personnel of firm promptly notify firm of circumstances and relationships that create a threat to independence. All breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.

At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

STUDY MATERIAL NEW

Ques-5 An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility?

Ans: Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. 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.

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

STUDY MATERIAL OLD

Ques-6 "The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats". Explain

Ans: Threats to Independence:

The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

1. Self-interest threats, which 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. Like, in case an audit firm unduly relies on fees from a client, it may result in threat to self-interest of auditor and he may not work objectively for the fear of losing client.

2. Self-review threats, which occur when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a

member of the audit team was previously a director or senior employee of the client. **Instances where such threats come into play are**

- (i) when an auditor is having recently been a director or senior officer of the company, and
- (ii) when auditors perform services that are themselves subject matters of audit.

3. Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. In such situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively. Remember that auditor has not only to be independent but also appear to be acting so.

4. 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:**

- (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. Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats. Such provisions prescribe that auditor is rotated after a certain number of years so that auditors do not become too familiar with their clients.

5. Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees or being threatened with litigation. Such threats attempt to intimidate auditors to deter them from acting objectively.

RTP MAY 19, MTP MAY 20

Ques-7 Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements. Discuss with reference to those fundamental principles of professional ethics

Ans. Ethical Requirements Relating to an Audit of Financial Statements: The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements.

The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements:

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behavior.

EXAM MAY 19, MTP OCTOBER 20

Ques-8 "Independence of mind and independence in appearance are interlinked perspectives of Independence of auditors". Explain.

Ans. "Independence" implies that the judgment of a person is not subordinate to the wishes or direction of another person who might have engaged him. The auditor should be independent of the entity subject to the audit. There are two interlinked perspective 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 comprising both-

(a) 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
 (b) 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." Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons.

RTP NOV 19, EXAM MAY 21, MTP MAY 20, MTP APRIL 21, RTP NOV 21, RTP MAY 2023

Ques-9 The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats. In the above context, explain the guiding principles.

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

The following are the guiding principles in this regard: -

1. 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.
2. In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.
3. Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
4. When such threats exist, the auditor should either desist from the task or put in place safeguards that eliminate them.
5. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

RTP NOV 19

Ques-10 Write a note on "Self-review threats"

Ans. Self-review threats, which occur when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are

- (i) when an auditor having recently been a director or senior officer of the company, and
- (ii) when auditors perform services that are themselves subject matters of audit.

RTP MAY 2023

Ques-11 Professional integrity and independence are considered essential characteristics of all the professions. There are two interlinked perspectives of independence of auditors, one, independence of mind and two, independence in appearance. Explain.

Ans. Professional integrity and independence are considered essential characteristics of all the professions but are more so in the case of accountancy profession. Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.

It is not possible to define "independence" precisely. Rules of professional conduct dealing with independence are framed primarily with a certain objective. The rules themselves cannot create or ensure the existence of independence. Independence is a condition of mind as well as personal character. It should not be confused with the superficial and visible standards of independence which are sometimes imposed by law.

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:**

(i) **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
(ii) **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."

Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons.