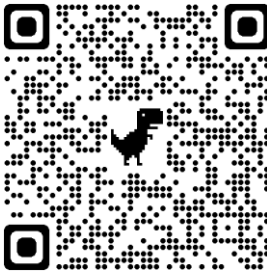

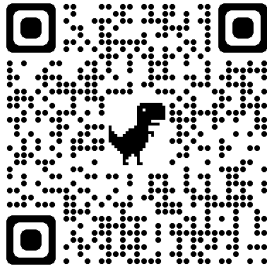



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TEAM CNC

STUDY MATERIAL QUESTIONS

QUESTION-1

The management of Exotic Tours and Travels Limited requests its auditor Raja & Co. to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures.

Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case?

ANSWER

Review Engagement:

- Raja & Co. can provide a review report in this case. Review is a limited assurance engagement and bus involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.
- Hence Raja & Co. can provide a report as requested by management of Exotic Tours and Travels Limited. Such report would be in nature of "Review".
- Raja & Co. will be required to obtain sufficient appropriate evidence based on limited procedures performed.

QUESTION-2

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

ANSWER

Assurance Engagements:

- Assurance Engagement is an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
- Scope of Assurance Engagements is not restricted to audit of financial statements only but it also extends to examination of Prospective Financial Information (PFI) and examination of internal controls.
- **Examples of various assurance engagements that can be rendered by a practitioner includes the following:**
 - a) **Audit of F.S.** - Reasonable assurance engagement
 - b) **Review of F.S.** - Limited assurance engagement
 - c) **Examination of PFI**- Provides assurance regarding reasonability of assumptions forming basis of projections and related matters.
 - d) **Report on controls operating at an organization** - Provides assurance regarding design and operation of controls.

QUESTION-3

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

ANSWER

Three Party Relationship Of Assurance Engagement:

An assurance engagement involves three parties - a practitioner, a responsible party, and intended users.

- a) **Practitioner:** Person who provides the assurance. Practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.
- b) **Responsible party:** Party responsible for preparation of subject matter.
- c) **Intended users:** Persons for whom an assurance report is prepared. These persons may use the report in making decisions.

QUESTION-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.

ANSWER

Examination Of Accounts For Determining Existence Of Fraud:

- Assurance engagement is an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
- Reasonable Assurance requires a high, but absolute assurance.
- In this case, a Chartered Accountant is specifically asked to check accounts whether fraud exists.
- **Conclusion:** - It is not a reasonable assurance engagement. It is in nature of investigation.

QUESTION-5

Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements of the company provide picture of healthy financial performance having robust turnover, low debt and good profits.

On above basis, he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct?

ANSWER

Objectives Of Audit:

- An audit does not provide assurance to investor in shares regarding safety of his prices of securities are affected by range of factors.
- An audit only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error.
- Conclusion: - Thinking of Lalji Bhai is not correct .

QUESTION-6

Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean.

During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company.

The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements.

The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit?

ANSWER

Scope Of Audit:

- **An Audit of Financial Statements include within its scope the following:**

- (1) **Coverage of all aspects of entity:** Audit of F.S. should be organized adequately to cover all aspects of the entity relevant to the F.S.
- (2) **Reliability and sufficiency of financial information:** Auditor should be reasonably satisfied that information contained in accounting records and other source data (like bills, vouchers, documents etc.) is reliable and provide sufficient basis for preparation of F.S.

(3) Proper disclosure of financial information: Auditor should decide whether relevant information is properly disclosed in F.S in compliance with applicable statutory requirements. For this purpose, auditor is required to study and assess accounting systems and internal controls.

- **Conclusion:** - Proper disclosure of financial information is well within scope of audit.

QUESTION-7

A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company.

Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a CA for verification of books of accounts/financial records of the company and circumstances surrounding the loss. He was also requested to submit an early report.

Would the report by CA in nature of audit report?

ANSWER

Examination Of Books Of Accounts For A Specific Purpose:

1. An Audit is independent examination of Financial Information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.
 2. Audit is not an official investigation into alleged wrong doing.
 3. In this case, CA was appointed for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company.
- **Conclusion:** - Work performed by CA is nature of investigation and hence his report will not be in nature of audit report.

QUESTION-8

"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.

ANSWER

Selection Of Accounting Policies:

- Choosing of appropriate accounting policies is responsibility of management. Role of auditor lies in evaluating selection and consistent application of accounting policies by management.
- **Auditor's duties in relation to accounting policies includes:** -
 - a) To evaluate whether accounting policies selected by management are proper and
 - b) Whether chosen policy has been applied consistently on a period-to-period basis.

QUESTION-9

CA. P Babu is conducting audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties and peculiar gain circumstances. However, such a procedure is mandated under one of Standards on Auditing.

Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company.

He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing?

ANSWER

Duties In Relation To Engagement And Quality Control Standards:

- It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them.

- However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement.
- ***In such a case, professional accountant is required to ensure the following:***
 - (a) Document how alternative procedures performed to achieve the purpose of required procedure
 - (b) Reason for departure has also to be documented; Report should draw attention to such departures.
- ***Conclusion:*** - CA P Babu is required to document how alternative procedures performed achieve the purpose of required procedure. Reason for departure has to be documented. His report should draw attention to such departure.

QUESTION-10

Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ & Co, Chartered accountants to audit their accounts for a year. The auditors were dib satisfied with control systems of firm, carried out required procedures and necessary verifications.

In particular, they carried out sample checking of purchases, traced purchase bills to GST portal and also made confirmations from suppliers. They were satisfied with audit evidence obtained by them as part of audit exercise. An audit report was submitted to the firm giving an opinion that financial statements reflected true and fair view of state of affairs of the firm.

However, later on, it was discovered that purchase manager responsible for procuring dresses from one location was also booking fake purchases of small values by colluding with unethical dealers. Payments to these dealers were also made in connivance with accountant through banking channel. The partners of firm blame auditors for futile audit exercise.

Are partners of firm correct in their view point? Imagine any probable reason for such a situation.

ANSWER

Inherent Limitations Of An Audit:

- a) An Audit suffers from inherent limitations due to which auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the F.S. are free from material misstatement due to fraud or error.
 - b) Circumstances as given in questions is an example of failure of internal controls of the firm. The internal control has not operated due to collusion between employees which is a limitation of internal control itself. The auditor has relied upon internal controls. It is very nature of financial reporting that management is responsible for devising suitable internal controls.
- ***Conclusion:*** - Partners of the firm are not correct. This is an inherent limitation of audit.

QUESTION-11

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.

ANSWER

Inherent Limitations of an Audit - Nature of Audit procedures:

- ***There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:***
 - a) 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.
 - b) 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 requested. 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.

- c) 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.
- d) 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.
- e) 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.

MCQS BASED QUESTIONS

1. Which of the following is not an advantage of audit?

- (a) It provides high quality financial information.
- (b) It acts as a moral check on employees.
- (a) It enhances risk of management bias.
- (b) It helps in safeguarding interests of shareholders.

2. Which of the following is NOT TRUE about an assurance engagement?

- (a) It relates to providing assurance about historical financial information only.
- (b) The practitioner obtains sufficient appropriate evidence.
- (c) There is some information to be examined by practitioner.
- (d) A written assurance report in appropriate form is issued by practitioner.

3. Which of the following is TRUE about Engagement Standards?

- (a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.
- (b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
- (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.
- (d) Engagement standards ensure savings in resources of clients.

4. Consider following statements in relation to "Limited assurance engagement":-

Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.

Statement II - Review of interim financial information of a company is an example of limited assurance engagement.

- (a) Statement I is correct. Statement II is incorrect.
- (b) Both Statements I and II are correct.
- (c) Both Statements I and II are incorrect.
- (d) Statement I is incorrect. Statement II is correct.

5. Which of the following is TRUE about Standards on auditing?

- (a) These deal mainly with voluntary responsibilities of auditors.
- (b) These deal mainly with mandatory responsibilities of auditors.
- (c) Their sole purpose is to help government authorities in augmenting revenues.
- (d) These deal mainly in carrying out audit according to legal provisions.

Answers to the MCQs based Questions

1. (c) 2. (a) 3. (c) 4. (d) 5. (b)

TRUE/FALSE QUESTIONS

QUESTION-1

The objective of audit is to obtain absolute assurance and to report on the financial statements.

ANSWER

Statement is incorrect.

- Objective of audit is to express an opinion on true and fair view of the financial statements. In this reference. SA-200 "Overall Objectives of the Independent Auditor and conduct of audit in accordance with Standards on Auditing" provides that 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;
 - (b) To report on the financial statements, and communicate as required by the SAS, in accordance with the auditor's findings.

QUESTION-2

The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity.

ANSWER

Statement is incorrect.

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

QUESTION-3

An audit is an official investigation into alleged wrongdoing.

ANSWER

Statement is incorrect.

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

QUESTION-4

As per SA 200 "Overall Objectives of the Auditor", in conducting an audit of financial statements, the overall objectives of the auditor is to obtain absolute assurance about whether the financial statements as a whole are free from material misstatement due to fraud.

ANSWER

Statement is Incorrect.

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 F.S. 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 F.S. are prepared, in all material respects, in accordance with applicable FRF; and
- (b) To report on the F.S., & communicate as required by the SAs, in accordance with the findings.

QUESTION-5

There is no difference between "audit" and "review."

ANSWER

Statement is Incorrect.

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

QUESTION-6

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

ANSWER

Statement is Incorrect.

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.

QUESTION-7

Historical Financial information relates to financial information based on assumptions about occurrence of future events and possible actions by an entity.

ANSWER

Statement is Incorrect.

"Historical financial information" means - information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

QUESTION-8

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.

ANSWER

Statement is Correct

- As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.
- This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable FRF.

QUESTION-9

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

ANSWER

Statement is Correct.

- As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.
- This is because there are inherent limitations of an audit, which result in most of the audit evidence on which auditor draws conclusions and bases auditor's opinion being persuasive rather than no conclusive.

QUESTION-10

The basic objective of audit does not change with reference to nature, size or form of an entity.

ANSWER

Statement is Correct.

- 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.
- It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

QUESTION-11

The term "Engagement Standards" refer to Standards on Auditing only.

ANSWER

Statement is incorrect.

Engagement Standards refer not only to Standards on auditing but also to Standards on review engagements, Standards on assurance engagements and Standards on related services.

QUESTION-12

Mr. S, one of the new team members of the auditor of Extremely Effective Limited was of the view that for the purpose of conducting an audit, only knowledge of direct tax is required whereas no knowledge of indirect tax is required.

ANSWER

Statement is incorrect.

The viewpoint of Mr. S is incorrect because for the purpose of conducting an audit, proper knowledge of both direct tax as well as indirect tax is required.

QUESTION-13

According to Mr. H, one of the team members of the auditor of Very Essential Limited was of the view that no relation exists between accounting and auditing from the point of view of a company.

ANSWER

Statement is incorrect.

- The viewpoint of Mr. H is incorrect because there exists a proper relation between accounting and auditing from the point of view of a company. Audit is conducted for financial statements of a company and those F.S. are prepared with the help of books of accounts of that company.
- In order to properly conduct an audit of a company, an auditor is required to be aware of accounting principles and accounting policies of that company.

QUESTION-14

The auditor is expected to and can reduce audit risk to zero.

ANSWER**Statement is incorrect.**

- As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.
- This is because there are inherent limitations of an audit, 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.

QUESTION-15

The preparation of financial statements involves judgment by management.

ANSWER**Statement is correct.**

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

QUESTION-16

Management of the organization is solely responsible for the compliance of auditing standards while preparing financial statements.

ANSWER**Statement is incorrect.**

- Responsibility for the compliance of Auditing Standards is of Auditor. While carrying out the audit, 1900 auditor is required to ensure that audit is been performed in accordance with Standards on Auditing and appropriate Report is issued.
- Management is responsible for the compliance of Accounting Standards.

QUESTION-17

The Auditor is expected to, reduce audit risk to zero and can therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

ANSWER**Statement is incorrect.**

- As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. gad
- This is because there are inherent limitations of an audit.

QUESTION-18

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 conclusive rather than persuasive

ANSWER

Statement is incorrect.

- As per SA 200, the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.
- This is because there are inherent limitations of an audit, 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.

CASE SCENARIO

Case study-1

Me and You Private Limited has been newly incorporated. The plant of the company has recently started production with the help of funds provided by a bank for purchase and installation of machinery. Further, the company is also utilizing working capital credit facilities from the same bank for meeting its day to day working capital requirements like for purchase of raw materials, labor payment etc. However, just within six months of its operations, the management feels that working capital funds are inadequate and situation is creating liquidity issues in the company.

The management of the company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager is insisting upon financial statements of the company for half year along with report providing assurance in this respect duly signed by Chartered Accountant as audit is far away. It also requires projected financial statements for coming years along with a report from CA providing assurance regarding these projections to consider request of management.

The management approaches CA P, who has qualified recently and started practicing. Reports providing assurance for half yearly results and projected financial statements are sought from CA P. The Management provides necessary information and records to him in this regard.

Assume, in above case, the company only provides trial balance, financial statements in draft/preliminary form along with accompanying records for the relevant half year to CA P and requests him to provide duly signed financial statements with a report for mutually agreed professional fees.

➤ ***Based on above, answer the following questions:***

Q.1 The management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?

- (a) Standards on Review Engagements
- (b) Standards on Auditing
- (c) Standards on Related Services
- (d) There are no standards for issuing report in such situation.

Q.2 Which of the following statements is MOST APPROPRIATE in given case situation?

- (a) CAP can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work.
- (b) CA P can assist management in preparation of financial statements of the company and he can issue an audit report. CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect.
- (c) The responsibility of preparation of financial statement is of company's management. CA P cannot assist management in preparation of financial statements of the company. However, he can issue a review report.

Q.3 In the above said scenario for issuance of signed financial statements for half year by CA P, as of mi discussed in last para of Case Study, identify the MOST APPROPRIATE statement:

- (a) Standard on Quality control (SQC 1) is not applicable as CAP cannot issue audit report. T
- (b) Standard on Quality Control (SQC 1) is not applicable as CA P cannot issue review report.
- (c) Standard on Quality Control (SQC 1) is applicable in such type of engagement.
- (d) Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.

Q.4 The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?

- (a) Standards on Review Engagements
- (b) There are no standards for issuing such type of reports.
- (c) Standards on Related Services
- (d) Standards on Assurance Engagements

Q.5 Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. The management has projected turnover of ₹ 100 crore for the next year, ₹ 150 crore & ₹ 200 crore for following years respectively as compared to present turnover of ₹ 25 crore in current half year. Identify the MOST APPROPRIATE statement in this situation: -

- (a) CAP has to satisfy himself regarding arithmetical accuracy of projected data.
- (b) CAP has to satisfy himself regarding reasonableness of assumptions underlying projected turnover and its consistency with actuals.
- (c) CA P has to satisfy himself regarding arithmetical accuracy of data along with its proper presentation to banker.
- (d) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover, its consistency with actuals, disclosure and presentation.

Answer

- 1 (c)
- 2 (c)
- 3 (c)
- 4 (d)
- 5 (d)

Case Study – 2

Rohit, Gurpreet, Ali and Goreti are friends since their school days based in Mumbai. They have cleared CA foundation exams in the same attempt and now plan to appear for CA Intermediate exams. All of them are avid news listeners and regularly keep track of business news even on social media.

They are trying to understand new subjects including auditing. Rohit, Gurpreet and Ali have also started attending Live Coaching Classes (LCC) being conducted by Board of studies of ICAI. Goreti has not been able to join Live Coaching Classes yet as she was away on a holiday with her parents. However, she plans to catch it up with her friends very soon. Ali had also joined the classes but he had skipped some lectures.

During one informal get together, their discussions centered around new subject of auditing. They discussed many things regarding its nature, scope, benefits and other general practical issues. Goreti was regular in keeping track of audited results of companies being published in leading newspapers. Her view was that audited financial statements of companies give 100% guarantee to different stake holders. It is the main reason behind so much reliance upon

auditing. But she could not understand why wrong doings in financial matters are being discovered after many years have gone by.

Ali also concurred with her view and added that when financial statements are audited, each and every transaction appearing in books of accounts is verified. However, he could not give clarity to Goreti. Gurpreet was of the opinion that audit was conducted on the basis of sample checking. He was also of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of the companies. Not to be left behind, Rohit also jumped in the fray. He supported Gurpreet and also added something of his own.

➤ ***Based on above, answer the following questions:***

Q.1 Gurpreet was of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of companies. What kind of assurance does audit of financial statements provide?

- a) It provides reasonable assurance meaning a moderate level of assurance.
- b) It provides reasonable assurance meaning a low level of assurance.
- c) It provides reasonable assurance meaning a high level of assurance.
- d) It provides reasonable assurance meaning an absolute level of assurance.

Q.2 Rohit added that auditor can force an employee of the company to provide him required information and documents. Can he do so? documents. Can he do so?

- a) Yes, he can do so. It is necessary to obtain audit evidence.
- b) Yes, he can do so. There are express rights given to him in this respect.
- c) No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him.
- d) No, he cannot do so. He has no right of seeking information and documents. Therefore, question of forcing does not arise.

Q.3 Ali had listened in one of the classes that audit covers all aspects of an entity and concluded that each and every transaction of entity is verified by auditor.

Goreti also seemed to be in agreement with him but she was of the view that besides this, it also meant that audit should be so organized to cover all areas of an entity. Which of following statements is appropriate in this regard?

- a) Only view of Ali is correct.
- b) Only view of Goreti is correct.
- c) Views of both Ali and Goreti are correct.
- d) Views of both Ali and Goreti are incorrect.

Q.4 All of them also discussed about benefits of auditing. Which of the following is not a likely benefit of auditing?

- a) Since auditing is connected to future events, audited information can be easily relied upon by users.
- b) Errors or frauds may be discovered during audit.
- c) Government authorities can make use of audited accounts for different purposes.
- d) It can help in bringing out deficiencies in maintenance of financial records

Q.5 Goreti told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?


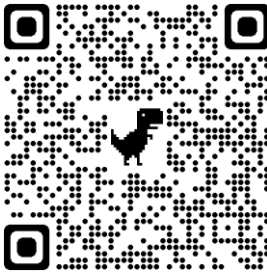




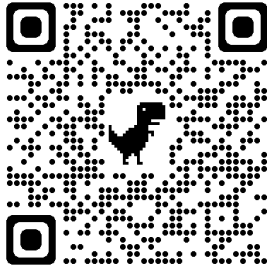
- a) It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.

- b) Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.
- c) Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.
- d) Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare odd cases.

Answer

1. (c)
2. (c)
3. (d)
4. (a)
5. (c)

CA NOTES COMMUNITY NETWORK

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TEAM CNC

STUDY MATERIAL QUESTIONS

QUESTION-1

W, the auditor of SKM Ltd. asks its finance and audit head to prepare audit strategy for conducting audit of SKM Ltd. W also insists him to draw detailed audit procedures. On the request of auditor W completes audit strategy as well as audit procedures as prepared by finance head of the company.

Subsequently, auditor realizes that effectiveness of the audit is compromised and it was his responsibility to prepare the overall audit strategy. Comment.

ANSWER

Overall Audit Strategy & Audit Plan - Auditor's Responsibility

1. Overall audit strategy and audit plan remain the auditor's responsibility. It is the auditor who is responsible for establishing overall audit strategy and developing audit plan.
2. However, auditor may discuss elements of planning with entity's management without compromising effectiveness of audit.
3. In the given case, On the request of auditor audit strategy as well as audit procedures are prepared by finance head of the company.
 - **Conclusion:** - Approach of W was wrong and he should have prepared overall audit strategy and detailed audit procedures.

QUESTION-2

CA Mary, while planning audit of a company, feels that she would inquire from in house legal counsel of the company status of pending litigation matters against the company to identify and assess risks of material misstatements. Considering above description, are you able to identify said procedures?

Where these identified procedures are included in planning in accordance with SA-300?

ANSWER

Development Of Audit Plan

- **SA-300 states that auditor shall develop an audit plan that shall include description of:**
 - (1) Nature, timing and extent of planned risk assessment procedures;
 - (2) Nature, timing and extent of planned further audit procedures at assertion level; an
 - (3) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.
- In this case, auditor would like to inquire from in house legal counsel of the company as to status of pending litigation matters to identify and assess risk of material misstatement.
- The objective of planned inquiry of in house legal counsel is to identify and assess risk of material misstatement.
- **Conclusion -** Planned risk assessment procedures are included in audit plan in accordance with SA- 300.

QUESTION-3

An auditor of a company fails to document audit strategy and audit plan. Briefly outline consequences of such failure.

ANSWER

Consequences Of Failure To Document Audit Strategy And Audit Plan

- Documentation of overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to ET.
- Documentation of the audit plan is a record of the planned NTE of RAPS and FAPs 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.
- Record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned NTE of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit.
- If auditor fails to document audit strategy and audit plan, he will not be able to carry out audit in an efficient and effective manner and will not be able to prove that audit was planned and performed in accordance with Standards on Auditing.

QUESTION-4

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

ANSWER

Elimination of disadvantages of audit programme:

Disadvantages of an Audit programme may be eliminated by:

- (1) imaginative supervision of the work carried on by the assistants;
- (2) receptive attitude of auditor as regards the assistants
- (3) encouraging assistants to observe matters objectively and bring significant matters to the notice of supervisor/principal.

QUESTION-5

Rohit, undergoing practical training, is part of an engagement team conducting audit of a company engaged in manufacturing of paints. He has been provided with audit programme pertaining to sales. It lists out various items to be checked and verified by him including invoices, rate lists, posting in debtor's accounts, correlation of invoices with e-way bills on sample basis etc.

During verification, he notices that many e-way bills have been cancelled by the company within 24 hours of their generation in month of March. There is no specific instruction in audit programme in this regard. He keeps mum. Is attitude of Rohit proper?

ANSWER

Assistants to keep an Open Mind

- Assistants engaged should be encouraged to keep an open mind beyond the programme given to him. They should be instructed to note and report significant matters coming to their notice, to seniors or partners or proprietor of the firm.
- In this case, Rohit notices that many e-way bills have been cancelled by the company within 24 hours of their generation in month of March. There is no specific instruction in audit programme in this regard. He keeps mum.
- **Conclusion: - Attitude of Rohit is not proper.** Reasons for cancellation of many e-way bills in month of March need to be looked into. Matter should be informed to engagement partner.

QUESTION-6

CA Shubhendu is statutory auditor of a social media company. Due to change in information technology regulations by government, it has become mandatory for such companies to constitute "grievance redressal mechanism" for users of social media platform of the company.

Failure to comply with regulations can potentially lead to civil and criminal liabilities against the company.

Is above factor to be considered by auditor while framing audit strategy?

ANSWER

Consideration Of Changes In Law While Establishing Audit Strategy:

- As per SA 300 "Planning an Audit of F.S." auditor shall establish an overall audit strategy that sets scope, timing and direction of the audit, and guides the development of the audit plan.
- Changes in laws and regulations affecting the company is a factor to be considered while establishing overall audit strategy.
- There has been change in information technology regulations applicable to the company. Noncompliance of the same can have implications in form of civil and criminal liabilities.
- **Conclusion:** - Matter concerning changes in laws and regulations is to be considered by auditor while establishing overall audit strategy.

QUESTION-7

Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to client.

ANSWER

Evaluating Compliance With Ethical Requirements, Including Independence

- As a part of Preliminary Engagement Activities, auditor is required to evaluate compliance with ethical requirements including independence.
- **EP shall form a conclusion on compliance with independence requirements. In doing so, he shall:**
 1. Obtain relevant information from the firm to identify and evaluate circumstances & relationships that create threats to independence.
 2. Evaluate information on identified breaches, if any, to determine whether they create a threat to independence for audit engagement.
 3. 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.
 4. EP shall promptly report to the firm any inability to resolve the matter for appropriate action.

QUESTION-8

Discuss how performing preliminary engagement activities as part of planning an audit assists auditor.

ANSWER

Preliminary Engagement Activities

- **As per SA 300 "Planning an Audit of F.S.", preliminary engagement activities include the following:**
 - (1) Performing procedures regarding the continuance of the client relationship.
 - (2) Evaluating compliance with ethical requirements, including independence.
 - (3) Establishing an understanding of terms of engagement.
- 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

QUESTION-9

MG & Co, a firm of auditors, having a standing of 30 years is appointed as a statutory auditor of company engaged in manufacturing of defense equipment. Due to opening of defense sector by government to private players in recent times, many new companies have entered the fray to manufacture sophisticated defense equipment.

Considering technical and complex nature of operations, the auditors recognize that involvement of experts in the audit is required. Does consideration for involvement of experts by auditors fall in the domain of planning audit?

ANSWER

Involvement Of Experts In Planning:

- Planning in auditing encompasses developing an overall plan for the expected scope and conduct of the audit and developing an audit programme showing the nature, timing and extent (NTE) of audit procedures.
- While planning an audit, auditor would have to consider whether involvement of experts is necessary.
- In the stated case, company is involved in technical and complex operations. Therefore, while planning an audit, auditors would have to consider whether involvement of expert is necessary.
- **Conclusion:** - Consideration for involvement of experts by auditors falls within domain of planning.

QUESTION-10

CA Kartik is planning for audit of a company engaged in manufacturing of cosmetics. Considering nature of operations of the company, he had planned to include testing of controls of the company over purchases, sales and inventories.

One fine day, he reaches the corporate office and asks for manuals and required documentation to ensure surprise element in testing.

He had never shared with management his intention to carry out above procedures. Is approach of CA Kartik proper?

ANSWER

Discussion Of Elements Of Planning With Management

- a) Auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement without compromising effectiveness of audit.
 - b) In the case, CA Kartik has reached office of the company without sharing with management his intention to test the controls. Sharing details of visit to test controls does not compromise effectiveness of audit. It is for the better facilitation and conduct of audit.
- **Conclusion:** - Approach of CA Kartik is not proper.

QUESTION-11

The auditor T of Hand Fab Ltd is worried as to management of key resources to be employed to conduct audit.

How the audit strategy would be helpful to the auditor?

Answer

Benefits of Audit Strategy:

- a) **Employment of Qualitative Resources:** Audit strategy helps in deploying the appropriate resources for specific audit areas, such as the use of experienced team members for high risk areas or the involvement of experts on complex matters.
- b) **Allocation of Quantity of Resources:** Audit strategy helps in allocating the appropriate number of resources 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.
- c) **Timing of Deployment of Resources:** Audit strategy helps in determining the timing of deploying the resources, such as whether at an interim audit stage or at key cut-off dates.
- d) **Management of Resources:** Audit strategy helps in managing, directing, supervising the resources, 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.

QUESTION-12

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.

ANSWER

Planning The Direction And Supervision Of Engagement Team:

- As per SA 300 "Planning an Audit of Financial Statements" 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:
 - a) The size and complexity of the entity.
 - b) The area of the audit.
 - c) The assessed risks of material misstatement.
 - d) The capabilities and competence of the individual team members performing the audit work.

MCQS BASED QUESTIONS

1. **Which of the following is not considered in planning an audit generally?**
 - (a) Understanding of legal and regulatory framework of an entity
 - (b) Need to consider determination of materiality
 - (c) Evaluating audit evidence
 - (d) Need to consider involvement of expert
2. **Which of the following is true about audit plan?**
 - (a) Once an audit plan has been finalized for an engagement, changes cannot be made to it.
 - (b) Audit plan includes scope, timing and direction of planned risk assessment procedures.
 - (c) Changes in audit plan cannot lead to change in audit strategy.
 - (d) Audit plan has to be documented by auditor.
3. **Which of the following is not included in an audit programme normally?**
 - (a) Extent of checking
 - (b) Date of checking
 - (c) Nature or type of procedure
 - (d) Planning of risk assessment procedures
4. **Which of the following is not an advantage of an audit programme?**
 - (a) It acts as a guide for audit of coming years.
 - (b) It fixes responsibility of assistants.
 - (c) It serves as a shelter for assistants.
 - (d) It serves a proof of work done by auditor.
5. **Which of the following is most important principle for formulating an audit plan?**
 - (a) Gaining knowledge of client's workforce
 - (b) Gaining knowledge of client's business
 - (c) Gaining knowledge of client's vendors

(d) Gaining knowledge of tax laws applicable to client

Answers to the MCQs based Questions

1. (c) 2. (d) 3. (d) 4. (c) 5. (b)

TRUE/FALSE QUESTIONS

QUESTION-1

Audit notes can serve as a guide in framing an Audit programme.

ANSWER

Statement is correct.

Audit notes can serve as a guide in framing audit programme in the future as they indicate the weaknesses in the system of the client which specially need to be watched.

QUESTION-2

Evolving one audit programme applicable to all business under all circumstances is not practicable

ANSWER

Statement is correct.

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

QUESTION-3

Once the audit plan has been drafted and communicated, it is obligatory on the auditor to follow the same.

ANSWER

Statement is Incorrect.

- 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.

QUESTION-4

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.

ANSWER

Statement is Correct.

- 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.

QUESTION-5

Development of an audit plan is important before the establishment of the overall audit strategy to address the various matters.

ANSWER

Statement is Incorrect

- 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.
- 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.

QUESTION-6

Once the overall audit has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy.

The establishment of the overall audit strategy and the detailed audit plan are closely inter-related.

ANSWER

Statement is correct.

- 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.

QUESTION-7

The "documentation of the overall audit strategy" is a record of the audit evidences considered necessary to properly plan the audit and to assign various audit functions to the engagement team.

ANSWER

Statement is incorrect.

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

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

QUESTION-8

A well designed and drafted audit plan and audit strategy which takes care of all the uncertainties and conditions, need not be changed during the course of audit.

ANSWER

Statement is Incorrect.

- The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit.
- **The auditor may need to modify the overall audit strategy and audit plan as a result of:**
 1. Unexpected events,
 2. Changes in conditions, or
 3. The audit evidence obtained from the results of audit procedures.

QUESTION-9

Planning is not a discrete phase of an audit, but rather a continual and iterative process.

ANSWER**Statement is Correct.**

- 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.
- Planning often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

QUESTION-10

The auditor need not discuss elements of planning with the entity's management in any case.

ANSWER**Statement is incorrect.**

The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement.

QUESTION-11

Under a properly framed audit programme by the auditor, the danger is significantly less and audit can proceed systematically.

ANSWER**Statement is correct.**

- Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records.
- Under a properly framed programme, the danger is significantly less and the audit can proceed systematically.

QUESTION-12

Planning is a discrete phase of an audit.

ANSWER**Statement is Incorrect.**

- Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begin 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.

QUESTION-13

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.

ANSWER**Statement is Correct.**

- Once the overall audit strategy has been established, an audit plan can be developed 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.

QUESTION-14

Establishing an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan is prerogative of the management.

ANSWER**Statement is Incorrect.**

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.

QUESTION-15

The audit plan is more detailed than the overall audit strategy.

ANSWER**Statement is Correct.**

- 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.

QUESTION-16

A detailed Audit Programme once prepared for a business can be used for all business under all circumstances.

ANSWER**Statement is Incorrect.**

- 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.

QUESTION-17

In the planning stage, analytical procedures would not in any way assist the auditor.

ANSWER**Statement is incorrect.**

- 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.

QUESTION-18

Overall audit plan sets the scope, timing and direction of the audit, and guides the development of the more detailed audit strategy.

ANSWER

Statement is incorrect.

- Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

QUESTION-19

It is not necessary for the auditor to periodically review the audit programme.

ANSWER

Statement is incorrect.

- 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 face legal consequences.

QUESTION-20

The audit plan is more detailed than the overall audit strategy.

ANSWER

Statement is correct.

- 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.

QUESTION-21

The auditor should update and revise the audit plan as and when required, however, the overall audit strategy once established cannot be changed during the course of audit.

ANSWER

Statement is incorrect.

- 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.

CASE SCENARIO

Kaur & Associates, a sole proprietor firm of Simran Kaur, is offered appointment as auditor of a company engaged in manufacturing of automobile components for the first time. She is fact checking about the integrity of promoters of the company and key managerial persons. Matters such as competence of staff to perform the engagement are also considered by her. The appointment is subsequently accepted by her.

She is also taking into account number and location of branches of the company, requirements of Schedule III of Companies Act, 2013 and expected time by which audit has to be completed keeping in view statutory requirements.

Initially, she has thought it proper to inquire key employees of the company in procurement and marketing departments and planned for the same.

She has also planned to visit three plants of the company. The purpose of planned inquiry and visit is to identify and assess risk of material misstatements. A detailed set of instructions has been prepared by her office and it has been handed over to assistants in engagement team. These set of instructions include details of extent of checking and nature of audit procedures to be performed regarding purchases, sales, items of income, items of expenditure etc. During the course of execution of above set of instructions, it has been brought to her notice that company is also producing substantial quantities of scrap generated during manufacturing process. However, no instructions have been given to engagement team in this regard.

➤ **Based on above, answer following questions:**

Q.1 Auditor is fact checking about promoters and key managerial persons. She is also considering competence of staff to perform engagement. What is she trying to do?

- a) She is establishing audit strategy.
- b) She is conducting preliminary engagement activities.
- c) She is designing audit plan.
- d) She is checking her compliance of ethical requirements.

Q.2 Consideration of number and location of branches, requirements of financial reporting framework and expected time of completion are relevant factors primarily for which of the following -

- a) Developing audit plan
- b) Establishing overall audit strategy
- c) Designing audit programme
- d) Designing risk assessment procedures

Q.3 Taking into account description of planned inquiry and visit, which of the following statements is TRUE?

- (a) Planned inquiry and visit fall in area of audit strategy.
- (b) Planned inquiry and visit are planned risk assessment procedures and fall in field of audit plan.
- (c) The said description is not related to audit planning.
- (d) Planned inquiry and visit fall in scope of audit programme.

Q.4 What is detailed set of instructions given to assistants in engagement team known as?

- (a) Audit guidelines
- (b) Audit plan
- (c) Audit Programme
- (d) Audit Procedures

Q.5 The issue of generation of scrap has been overlooked in detailed set of instructions given to engagement team. What should be proper course of action by CA Simran Kaur?

- (a) She should ignore this information as audit has already begun.
- (b) She should modify earlier set of instructions.
- (c) She should leave the matter to wisdom of engagement team.
- (d) She should put the ball in court of management as she was not provided with complete information earlier.

ANSWER

1) (b)


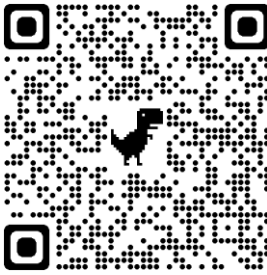


2) (b)

3) (b)

4) (c)

5) (b)

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STUDY MATERIAL QUESTIONS

QUESTION-1

Auditor GR and Associates, appointed for audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items.

While planning an audit, the auditor does not think that it would be necessary to understand internal controls. Advise the auditor in this regard.

ANSWER

Understanding Internal Controls:

- 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.

QUESTION-2

The team member of the auditor of Simple and Easy Limited was of the view that understanding the internal control of the company would not help them in any manner in relation to audit procedures to be applied while conducting the audit.

ANSWER

Understanding Internal Controls:

The view of the team member of the auditor is incorrect because understanding the internal control of the company would help the auditor and his team members in designing the nature, timing and extent of audit procedures to be applied while conducting the audit of the company.

QUESTION-3

CA Smriti is auditor of a company. As part of audit, she is going through company policies and practices regarding employee recruitment, training, orientation and related matters. She seems to be very much interested in finding out whether company hires best candidates from applicant pool.

Identify what she is trying to do? How gaining knowledge about this aspect is useful to her as an auditor?

ANSWER

Understanding Internal Controls:

- The study of company policies and practices regarding employee recruitment, training, orientation and related matters including hiring of best candidates is part of understanding HR function of the company.
- It, in turn, helps in understanding control environment of the company. By gaining such a knowledge, she can better understand internal control of the company.

QUESTION-4

During the audit of the same company, CA Smriti is keen to find out whether there exists a proper system of segregation of duties in the company. She wants to be sure that a person responsible for recording a transaction is different from the person authorizing it.

Discuss what she is trying to do and how its understanding is significant to her as an auditor.

ANSWER

Understanding Internal Controls:

- She is keen to find out whether there exists a proper system of segregation of duties in the company. She is gaining an understanding of internal control of the company.
- In particular, she is understanding "control activities". When a person recording a transaction is different from one authorizing it, she gains confidence that there exists a system for preventing misstatements.
- It helps her in gaining insight into the internal control system of the company.

QUESTION-5

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

ANSWER

Activities used to monitor internal control over financial reporting:

- Auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.
- ***Following point merit consideration in this regard:***
 - a) Monitoring of controls is a process to assess effectiveness of internal control performance over time.
 - b) It involves assessing the effectiveness of controls on a timely basis and taking necessary corrective actions.
 - c) Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
 - d) Management's monitoring activities may also 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.

QUESTION-6

What is understood by "non-routine" transactions? Briefly outline why risks of material misstatement is greater for such transactions What is understood by "non-routine" transactions? Briefly outline why risks of material misstatement is greater for such transactions

ANSWER

Non-routine transactions:

- Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.
- ***ROMM 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.

QUESTION-7

Mr. Y, one of the team member of the auditors of What and Where Limited was very keen in knowing whether the internal control of the company would safeguard the company's assets. Advise Mr. Y.

ANSWER

Review of Internal Controls:

Review of internal controls will enable the auditors to know whether the controls adequately safeguard the assets.

QUESTION-8

Mr. H, a team member of the auditor of There and Here Limited was of the view that evaluation of internal control of the company would help in identifying the areas where internal control is weak. Advise

ANSWER

Review of Internal Controls:

Review of internal controls will enable the auditor to know what are the areas where control is weak and where it is excessive.

QUESTION-9

In order to evaluate the Internal Control of Your and My Limited, a team member of the auditors used a method according to which, number of questions relating to internal control of the company were required to be answered by the employees of the company.

After obtaining the answers there was a discussion relating to those answers between team member of the auditor and employees of the company for a clear picture. State the method of evaluation of internal control as discussed above.

ANSWER

Method of Evaluation of Internal Control:

The method of evaluation of internal control used in the above question is known as Internal Control Questionnaire because in questionnaire method, a number of questions relating to internal control of a company are required to be answered by employees of that company and when answers to the questions are obtained, there is a discussion relating to those answers between team members of the auditors and employees of that company for a clear picture.

QUESTION-10

Healthy and Useful Limited is into small manufacturing as well as trading business. For the purpose of evaluating the internal control of Healthy and Useful Limited, a team member of the auditors of the company used a method according to which the whole description of internal control that was operating in the said company was to be recorded. Identify the method of evaluation of internal control as mentioned above.

ANSWER

Method of Evaluation of Internal Control:

The method of evaluation of internal control referred above is known as Narrative Record because in Narrative Record method, a whole description of internal control operating in an entity is recorded. Narrative Record method is also appropriate for small manufacturing as well as trading business as is mentioned in the question above case.

QUESTION-11

Zomba Products Private limited is a small company. The control systems in the company are rudimentary. How, you as an auditor of the company, would proceed to evaluate internal control of the company?

ANSWER

Method of Evaluation of Internal Control:

In a small company, control systems are basic and not formalized. Therefore, auditor should proceed to evaluate internal control using narrative record.

QUESTION-12

After assimilating the internal control system, auditor needs to examine whether and how far the same is actually in operation. For this, he resorts to actual testing of the system in operation.

Explain what can be included in Tests of Controls.

ANSWER

Elements of ToCs:

Tests of control may include:

- a) Inspection of documents supporting transactions to gain audit evidence that internal controls have operated properly, e.g., verifying that a transaction has been authorized.
- b) Inquiries and observation of internal controls which leave no audit trail, e.g., determining who actually performs each function and not merely who is supposed to perform it.
- c) Re-performance of procedures or controls that were originally performed as part of the entity's internal control, e.g., reconciliation of bank accounts, to ensure they were correctly performed by the entity.
- d) Testing of internal control operating on specific computerized applications or over the overall IT function, for example, access or program change controls.

QUESTION-13

Discuss relationship between "General IT controls" and "application controls" in an automated environment.

ANSWER

General IT controls and Application controls:

- These two categories of control over IT systems are interrelated.
- Relationship between application controls and General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

QUESTION-14

Manual elements in internal control may be less reliable than automated elements because they can be more easily bypassed, ignored, or overridden and they are also more prone to simple errors and mistakes.

Give examples of circumstances in which manual control elements may be less suitable.

ANSWER

Circumstances in which Manual Elements are less suitable:

- a) High volume or recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated.
- b) Control activities where the specific ways to perform the control can be adequately designed and automated.

QUESTION-15

While carrying out audit in automated environment, what should be the audit approach.

ANSWER

Audit Approach in an Automated Environment:

- a) Risk Assessment;
- b) Understand and evaluate;
- c) Test for Operating Effectiveness; and
- d) Reporting.

QUESTION-16

Briefly Explain use of Digital Technologies in carrying out an audit of financial statements.

ANSWER**Use of Digital Technologies in carrying out an audit of financial statements:**

- Entities are embracing digitization as part of their operations to keep pace with changing times. New technologies are helping companies revamp their operations and rethink the way business is conducted. Companies are restructuring their business models driven by technology. Automation is key to digitization.
- In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion.
- Auditors are making use of artificial intelligence, data analytics & other latest technologies to help understand business processes in a better way. By using such tools, auditors can conduct audit in a better and devote more attention to areas requiring greater focus.
- Digital audit is helping auditors to better identify risks making use of technology.

QUESTION-17

A Chartered accountant during course of audit of a company finds that cash is not deposited into bank frequently although concerned staff of company was required to do so.

Further, the official responsible for ensuring performance of above function, has also not paid any attention to it. Discuss what does it represent from auditor's perspective.

ANSWER**Control Deficiency:**

- Facts of the question highlights that cash is not deposited into bank frequently, although, concerned staff of company was required to do so.
- Further, the official responsible for ensuring performance of above function, has also not paid any attention to it. It means that control is not working as planned. It would not be able to prevent misstatement and very purpose of control is defeated.
- It represents a "control deficiency".

QUESTION-18

XYZ Ltd is engaged in the business and running several stores dealing in variety of items such as ready made garments for all seasons, shoes, gift items, watches etc. There are security tags on each and every item. Moreover, inventory records are physically verified on monthly basis.

Discuss the types of inherent, control and detection risks as perceived by the auditor.

ANSWER**Inherent, control and detection risks:**

(a) Inherent Risk: Because items may have been misappropriated by employees, therefore, risk to the auditor is that inventory records would be inaccurate.

(b) Control Risk: There is a security tag on each item displayed. Moreover, inventory records are physically verified on monthly basis. Despite various controls being implemented at the stores, still collusion among employees may be there and risk to auditor would again be that inventory records would be inaccurate.

(c) Detection Risk: Auditor checks the efficiency and effectiveness of various control systems in place. He would do that by making observation, inspection, enquiry, etc. In addition to these, the auditor would also employ sampling techniques to check few sales transactions from beginning to end. However, despite all these procedures, the auditor may not detect the items which have been stolen or misappropriated.

QUESTION-19

A Partnership Firm of Chartered Accountants HT and Associates was appointed to audit the books of accounts of Wind and Ice Limited for the financial year 2023-24. There was a risk that HT and Associates would give an inappropriate audit opinion if the financial statements of Wind and Ice Limited are materially misstated.

State the Risk mentioned in the question

ANSWER**Audit risk:**

Risk mentioned in the question is known as Audit Risk, because risk that auditor of a company will give an inappropriate audit opinion if the financial statements of that company are materially misstated is known as Audit Risk.

QUESTION-20

Wear & Tear Private Limited is a "start-up" engaged in providing holistic solutions to problem of paddy stubble burning mainly catering to needs of farmers of North western India. Due to importance given by governments to this issue, companies have entered in the market in past few years.

Many of these companies have not been successful and have gone bust. As an auditor of the company, can you spot the component of risks of material misstatement involved in above?

ANSWER**Component of ROMM:**

Facts given in the question highlights that many companies engaged in providing holistic solutions to problem of stubble burning have not been successful. It shows that line of activity is inherently risky. Therefore, there is a greater possibility of misstatements.

Conclusion: -Component of RoMM involved is "inherent risk."

QUESTION-21

A company has devised a control that its inventory of perishable goods is stored in appropriate conditions in a controlled environment to prevent any damages to inventory.

Responsibility is fixed on two persons to monitor environment using sensors and to report on deviations. Identify the component of risks of material misstatement involved as an auditor of the company.

ANSWER**Component of ROMM:**

- Facts given in the question highlights that inventory of perishable goods is stored in appropriate conditions and responsibility is fixed on two persons to monitor environment using sensors and to report on deviations.
- There is a possibility that persons given responsibility do not perform their work and report deviations.
- **Conclusion:** -Component of RoMM involved is "control risk".

QUESTION-22

Shree Foods Private Limited is engaged in manufacturing of garlic bread. The auditors of company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Which risk is being alluded to?

ANSWER

Detection Risk:

Facts given in the question highlights that there is a possibility that planned audit procedures may not achieve desired result and fail to detect misstatements in revenue recognition.

Conclusion:

The risk alluded to it is "detection risk".

QUESTION-23

JoJo Limited is planning to list on Bombay Stock Exchange next year. As an auditor of JoJo Limited, identify any one reason of increased audit risk due to listing of the company next year.

ANSWER

Reason of increased audit risk due to listing:

- Based on the facts given in the question, there is a greater chance of misstatements in the financial statements due to planned listing next year.
- There could be a possibility of intentional manipulation of F.S. so that good response is received to proposed issue.
- **Conclusion:** -There is increased audit risk i.e., risk of expressing inappropriate opinion by the auditor when financial statements are materially misstated.

QUESTION-24

On perusing financial statements of JoJo Limited put up for audit, it is observed by the auditor that current ratio has improved from 1.20:1 (in preceding year) to 1.75:1 (in current year).

Identify what kind of risk assessment procedures are being performed by auditor? Has it any relation with listing of the company next year on Bombay Stock Exchange?

ANSWER

Risk Assessment Procedure:

- Facts given in the question highlights that current ratio has improved from 1.20:1 (in preceding year) to 1.75:1 (in current year). The auditor is using "analytical procedures" as risk assessment procedures.
- Current ratio has improved from previous year. There could be a possibility of misstatement in current assets and current liabilities.
- It is possible that improvement in current ratio is artificial due to misstatements and has been done to secure good response to the proposed issue of company next year.
- **Conclusion:** -Auditor is using "analytical procedures".

QUESTION-25

Discuss how "analytical procedures" performed as "risk assessment procedures" can be useful to an auditor.

ANSWER

Use of Analytical Procedures as Risk Assessment procedures:

- Analytical procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing RoMM in order to provide a basis for designing and implementing responses to the assessed risks.
- Analytical procedures may include both financial and non-financial information.
- Analytical procedures may help identify 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 ROMM, especially ROMM due to fraud.

QUESTION-26

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

ANSWER**Components of risk of material misstatement:**

- ROMM 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:***
 - a) **Inherent Risk:** Susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, assuming that there were no related internal controls.
 - b) **Control Risk:** 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.

QUESTION-27

"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.

ANSWER**Combined Assessment of ROMM:**

- SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "ROMM". However, auditor may make separate or combined assessments of inherent and control risk depending on audit techniques or methodologies and practical considerations.
- ***Assessment of ROMM may be expressed in quantitative terms, such as in percentages, or in non- quantitative terms:***

Audit risk = Risks of material misstatement - Detection risk

Audit risk = Inherent risk × Control risk × Detection risk

QUESTION-28

One of the team members of auditors of Highly Capable Limited was of the view that Materiality and Audit Risk are only considered at planning stage of an audit.

Comment as an auditor.

ANSWER**Consideration of Materiality and Audit Risk:**

Concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

QUESTION-29

CA A. Raja is auditor of Build Well Forgings Private Limited having a revenue of ₹ 25 crores. The company has been sanctioned a term loan of 50 lacs from a bank.

However, as at end of the year, only ₹ 1 lac was availed due to delay in procurement of asset. The financial statements of the company do not disclose nature of security against which loan has been taken.

Schedule III of Companies Act, 2013 requires disclosure in this respect. Discuss, whether, non-disclosure of nature of security is material for auditor.

ANSWER

Consideration of Materiality:

If there is any statutory requirement of disclosure, it is to be considered material. Schedule III mandates disclosure of nature of security in relation to loan. The amount involved is irrelevant.

QUESTION-30

Is materiality required to be documented by the auditor? What factors have to be considered this regard?

ANSWER

Documentation of Materiality:

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) to (c) as the audit progressed.

QUESTION-31

The auditor of ABC Textiles Ltd chalks out an audit plan without understanding the entity's business. Since he has carried out many audits of textile companies, there is no need to understand the nature of business of ABC Ltd. Advise the auditor how he should proceed.

ANSWER

Understanding of the Entity:

Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analyzing information throughout the audit. Hence, auditor should proceed accordingly.

QUESTION-32

While auditing the books of accounts of Heavy Material Limited for the financial year 2023-24, a team member of the auditor of Heavy Material Limited showed no inclination towards understanding the business and the business environment of the above mentioned company.

Is the approach of team member of the auditor of Heavy Material Limited correct or incorrect? Also give reason for your answer.

ANSWER

Understanding of the Entity:

Approach of team member of the auditor of Heavy Material Limited is incorrect because understanding the business and the business environment of company whose audit is to be conducted is very important, as it helps in planning the audit and identifying areas requiring special attention during the course of audit of that company.

QUESTION-33

Prince Blankets is engaged in business of blankets. Its major portion of sales is taking place through internet. Advise the auditor how he would proceed in this regard as to understanding the entity and its environment.

ANSWER

Understanding of the Entity:

While understanding entity and its environment, internet sales is being perceived as risky area by the auditor and thereby would be spending substantial time and extensive audit procedures on this particular area.

QUESTION-34

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

ANSWER

Elements of Control Environment:

A. Control environment includes:

- a) The governance and management functions and
- b) The attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity.
- c) The control environment sets the tone of an organization, influencing the control consciousness of its people.

B. Control environment includes the following elements:

- a) **Communication and enforcement of integrity and ethical values:** These are essential elements that influence effectiveness of design, administration & 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 TCWG:** It includes attributes of TCWG such as their independence from management, their experience, extent of their involvement and the information they receive, and the scrutiny of activities.
- d) **Management's philosophy and operating style:** It comprises of management characteristics such as:
 - 1) Approach to taking and managing business risks.
 - 2) Attitudes and actions toward financial reporting.
 - 3) Attitudes toward information processing and accounting functions and personnel.
- e) **Organizational structure:** 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 authorization hierarchies are established.
- g) **Human resource policies and practices:** Policies & practices that relate to, e.g., recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

QUESTION-35

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

ANSWER

Internal Control Over Safeguarding Of Assets:

- Internal control over safeguarding of assets against unauthorized acquisition, use or disposition may include controls relating to both financial reporting & operations objectives.
- Auditor's consideration of such controls is generally limited to those relevant to reliability of financial reporting e.g., use of access controls, such as passwords, that limit access to data and programs that process cash disbursements may be relevant to F.S. audit.
- Safeguarding controls relating to operations objectives, such as controls to prevent excessive use of materials in production, generally are not relevant to F.S. audit.

Objectives of Internal Control are:

- a) 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; lot

- b) Assets are safeguarded from unauthorized access, use or disposition; and
- c) The recorded assets are compared

QUESTION-36

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

ANSWER

Concept of Data Analytics:

- Data analytics is an analytical process by which meaning information is generated and prepared from raw system data using processes, tools, and techniques.
- In an automated environment, various insights can be extracted from operational, financial, and other forms of electronic data internal or external to the organization.
- The data so extracted is useful for preparation of Management Information System (MIS) reports and electronic dashboards that give a high-level snapshot of business performance.
- The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATS.
- 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.

Application of Data Analytics:

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

1. Check completeness of data and population that is used in either test of controls or substantive audit tests.
2. Selection of audit samples - random sampling, systematic sampling.
3. Re-computation of balances - reconstruction of trial balance from transaction data.
4. Reperformance of mathematical calculations - depreciation, bank interest calculation.
5. Analysis of journal entries.
6. Fraud investigation.
7. Evaluating impact of control deficiencies.

MCQS BASED QUESTIONS

1. **Which of the following is true regarding materiality?**
 - (a) It is unaffected by nature of an item.
 - (b) It is unaffected by requirements of law or regulations.
 - (c) It is not a matter of professional judgment.
 - (d) It is not always a matter of relative size.
2. **The operations of a company are automated substantially. Which of the following statements is most appropriate in this respect?**
 - (a) It results in complex business environment.
 - (b) It results in simple business environment and easier audit.

- (c) Automation has no relationship with complexity of business environment.
- (d) It results in simple business environment. However, it increases complexity of audit.

3. **Who is responsible for maintaining effective internal financial controls?**

- (a) Statutory auditor
- (b) Audit Committee
- (c) Management
- (d) Shareholders

4. **Which of the following is not a risk to a company's internal control due to its IT environment?**

- (a) Potential loss of data
- (b) Inability to access data when required
- (c) Unauthorized access to data
- (d) Processing of large volumes of data

5. **Which of the following is not an example of "General IT controls"?**

- (a) Controls pertaining to Disaster recovery plan
- (b) Controls pertaining to batch preparation
- (c) Controls pertaining to data security
- (d) Controls pertaining to validation of input data in an application

Answers to the MCQs based Questions

1. **d** 2. **a** 3. **c** 4. **d** 5. **d**

TRUE/FALSE QUESTIONS

QUESTION-1

Risk assessment procedures are not performed to obtain an understanding of the entity and its environment.

ANSWER

Statement is incorrect.

Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

QUESTION-2

When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement.

ANSWER

Statement is correct.

- When audit procedures are designed to address an inherent risk or "what can go wrong", auditor consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence.
- When inherent risk is higher, auditor may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.

QUESTION-3

Determining materiality involves the exercise of professional judgment.

ANSWER

Statement is correct.

- 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.

QUESTION-4

The Complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be less complex.

ANSWER

Statement is incorrect.

- The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven.
- The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex. If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle then it is considered more complex to audit.
- On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

QUESTION-5

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

ANSWER

Statement is correct.

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

QUESTION-6

Internal control cannot eliminate risk of material misstatements in the financial statements.

ANSWER

Statement is correct.

- Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management. However, internal control can only reduce but not eliminate risks of material misstatement in the financial statements.
- This is because of the inherent limitations of internal control. There is possibility of human errors or mistakes, or of controls being circumvented by collusion. Accordingly, some control risk will always exist.

QUESTION-7

All automated environments are not complex.

ANSWER**Statement is correct.**

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

QUESTION-8

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

Answer**Statement is incorrect.**

- Objective of "Data Center and Network Operations" is to ensure that production systems are processed to meet financial reporting objectives.
- To ensure that systems are developed, configured and implemented to meet financial reporting objectives is covered within the function of "Application system acquisition, development, and maintenance".

QUESTION-9

The SAS do not ordinarily refer to inherent risk and control risk separately.

ANSWER**Statement is correct.**

- The SAS do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.
- 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.

QUESTION-10

Satisfactory Control environment is an absolute deterrent to fraud. [MTP-Nov. 21]

ANSWER**Statement is incorrect.**

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

QUESTION-11

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

ANSWER**Statement is Correct.**

Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred

during the audit, new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

QUESTION-12

In an automated environment, the relationship between the application controls and the General IT controls over IT systems are not interrelated.

ANSWER

Statement is incorrect.

- These two categories of control over IT systems are interrelated.
- The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

QUESTION-13

Understanding the Internal Control of a company will not help the auditor in developing an Audit Programme.

ANSWER

Statement is Incorrect.

Understanding the Internal Control of a company will help in developing an Audit Programme because it will assist the auditor and his team to understand as to how much they can rely on internal control of the company and what audit procedures would be appropriate to be used during the course of audit.

QUESTION-14

Narrative record is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer.

ANSWER

Statement is Incorrect.

Check list is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. Narrative record is a complete and exhaustive description of the system as in operation by the auditor.

QUESTION-15

If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered less complex and easy to audit compared to using an off-the-shelf accounting software.

ANSWER

Statement is incorrect.

If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

QUESTION-16

Maintenance of Internal Control System is the responsibility of the Statutory Auditor.

ANSWER

Statement is Incorrect.

The management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. Maintenance of Internal Control System is responsibility of management because the internal control is the process designed, implemented and maintained by those charged with governance/management to provide reasonable assurance about the achievement of entity's objectives.

QUESTION-17

Tests of control are performed to obtain audit evidence about the effectiveness of Internal Controls Systems.

ANSWER

Statement is Correct.

Tests of Control are performed to obtain audit evidence about the:

- a) the design of the accounting and internal control systems that is whether, they are suitably designed to prevent or detect or correct material misstatements and
- b) the operation of the internal controls throughout the period.

QUESTION-18

Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) does not need any revision.

ANSWER

Statement is incorrect.

As per SA 320 "Materiality in Planning and Performing an Audit" materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of-

- A change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business),
- New information, or
- A change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

QUESTION-19

Mr. W, one of the team members of auditor of Different Limited was of the view that understanding the Internal Control of Different Limited will not help in developing an Audit Programme.

ANSWER

Statement is incorrect.

Understanding the Internal Control of Different Limited will help in developing an Audit Programme because it will assist the auditor and his team to understand as to how much they can rely on internal control of the company and what audit procedures would be appropriate to be used during the course of audit.

QUESTION-20

"Maintenance of internal Control system is responsibility of Auditor.

ANSWER

Statement is Incorrect.

Maintenance of Internal control system is the responsibility of the Management. Auditor evaluates the internal control system for the purpose of determining Nature, Timing & Extent of Audit procedures.

QUESTION-21

Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

ANSWER

Statement is Incorrect.

- Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.
- Control risk, on the other hand is 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.

QUESTION-22

There is direct relationship between materiality and the degree of audit risk.

ANSWER

Statement is Incorrect.

- There is an inverse relationship between materiality and the degree of audit risk.
- The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

QUESTION-23

When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall not perform substantive procedures that are specifically responsive to that risk.

ANSWER

Statement is incorrect.

- When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk.
- When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.

QUESTION-24

The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven.

ANSWER

Statement is correct.

- The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven.
- The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex.

QUESTION-25

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

ANSWER

Statement is incorrect.

Inquiry is the most efficient audit test but it gives least audit evidence. Therefore, inquiry should be used in combination with other audit testing methods. Inquiry alone is not sufficient.

QUESTION-26

Application controls include manual controls only that operate at a business process level.

ANSWER

Statement is incorrect.

- Application controls are manual or automated procedures that typically operate at a business process level and apply to the processing of individual applications.
- Application controls relate to procedures used to initiate, record, process and report transactions or other financial data. These controls help ensure that transactions occurred are authorised, and are completely and accurately recorded and processed.

QUESTION-27

Inquiry alone is sufficient to test the operating effectiveness of controls.

ANSWER

Statement is incorrect.

- Inquiry alone is not sufficient to test operating effectiveness of controls; other audit procedures are performed in combination with inquiry.
- Inquiry combined with inspection or reperformance may provide more assurance than inquiry and robes and observation, since an observation is pertinent only at the point in time at which it is made.

QUESTION-28

The SAs ordinarily refer to inherent risk and control risk separately.

ANSWER

Statement is incorrect.

- 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 and practical considerations.

QUESTION-29

Satisfactory Control environment is not an absolute deterrent to fraud.

ANSWER

Statement is correct.

- The existence of a satisfactory control environment work as a positive factor when the auditor assesses the Risk of Material Misstatements.
- But at the same time, it is to be kept in mind that a satisfactory control environment is not an absolute deterrent to fraud. Deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud.

QUESTION-30

There is no relation between Inherent risk, Control risk and Detection risk.

ANSWER

Statement is Incorrect.

- Inherent Risk and Control Risk are collectively known as Risk of Material Misstatements.
- There is an inverse relationship between detection risk and the combined level of inherent and control risks. When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. 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.

QUESTION-31

The assessment of risks is a matter capable of precise measurement.

ANSWER**Statement is incorrect.**

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

QUESTION-32

The auditor's reporting on internal financial control will be applicable with respect to interim control will be financial statements.

ANSWER**Statement is incorrect.**

- Clause (i) of Sec. 143(3) of Companies Act, 2013 requires the company auditor to report whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.
- It may be noted that auditor's reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under Act and reported under Section 143.
- Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

QUESTION-33

For an auditor, the Risk assessment procedure provides sufficient appropriate audit evidence to base the audit opinion.

ANSWER**Statement is incorrect.**

- 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.

QUESTION-34

The internal control questionnaire is a series of instructions/ questions which a member of the auditing staff must follow and/or answer.

ANSWER**Statement is incorrect.**

- Checklist is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer.
- Internal control questionnaire is a comprehensive series of questions concerning internal control. The questionnaire is usually issued to the client and the client is requested to get it filled by the concerned executives and employees.

QUESTION-35

Materiality is not a matter of size.

ANSWER**Statement is Incorrect.**

- Financial statements should disclose all 'material items', i.e., the items the knowledge of which might influence the decisions of the user of the financial statement. Materiality is not always a matter of relative size.
- For example: a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future. In certain cases, quantitative limits of materiality are specified.

QUESTION-36

There is an inverse relationship between detection risks and the combined level of inherent and control risks.

ANSWER

Statement is correct.

- 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 risks to an acceptably low level.

QUESTION-37

Control environment can prevent, detect and correct a material misstatement.

ANSWER

Statement is incorrect.

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.

QUESTION-38

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

ANSWER

Statement is incorrect.

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

QUESTION-39

When Profit before tax from continuing operations is non-volatile, other benchmarks will be appropriate.

ANSWER

Statement is incorrect.

Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.

CASE SCENARIO

Case Study – 1

CA Paritosh is auditor of a company. The financial statements of the company have just been received for audit. Following issues have been flagged pertaining to the financial statements of the company for purpose of risk assessment: -

The revenue of company has fallen from 50 crore in last year to 5 crore in current year (for which financial statements have been received for audit) due to lack of demand in the market for company's products.

Due to advent of new products in the market, company's products are fast becoming outdated.

A large customer having an outstanding balance of ₹ 5 crore has failed to pay to the company despite efforts made by the company.

Inventory holding period has increased from 30 days in last year to 90 days.

The company also gets carried out job operations from third parties. Therefore, parts of inventories are lying with third parties.

➤ Based on above, answer the following questions:

Q.1 Regarding drastic fall in revenue of the company, which of the following is an audit risk?

- a) Fall in revenue would result in fall of profits for the company.
- b) Drastic fall in revenue may imply that company is not able to carry out its operations in foreseeable future due to lack of demand in the market for company's products. There is a risk that going concern disclosure is omitted to be made in financial statements.
- c) The company can explore some new line of activity, if demand of its products is falling.
- d) Fall in revenue would mean lower tax liabilities for the company.

Q.2 The company's products are getting outdated in the market. Which of the following is an audit risk?

- a) The company should devise strategies to sell products in the market.
- b) Inventories may be understated in such a scenario.
- c) Inventories may be overstated in such a scenario.
- d) The company should launch a 1+1 free offer for its customers.

Q.3 A large customer has failed to pay to the company. Identify audit risk from below:

- a) Receivables may be misstated if irrecoverable debt is not written off.
- b) Receivables may be overstated if irrecoverable debt is not written off.
- c) Writing off irrecoverable debt would impact profits of company adversely.
- d) Failure to recover outstanding debt would impact cash flows of company adversely.

Q.4 Identify audit risk involved when inventory holding period has increased from 30 days to 90 days.

- a) There is a risk of overstatement of inventories.
- b) There is a risk relating to existence of inventories.
- c) There is a risk that slow movement of stocks would increase tax liability when GST rates are increased.
- d) There is a risk relating to holding and storage cost of inventories.

Q.5 Part of inventories are lying with third parties. Identify audit risk involved.

- a) There is a risk that third parties do not manufacture according to specifications of the company.
- b) There is a risk that by getting job work done from third parties, company is increasing its costs.
- c) There is a risk that sufficient and appropriate evidence would not be available in respect of quantity and condition of inventories lying with third parties.
- d) There is a risk that sufficient and appropriate evidence would not be available for quality control in respect of inventories lying with third parties.

ANSWER

1. (b)

2. (c)

3. (b)
4. (a)
5. (c)

Case Study - 2

CA Piyush is understanding internal controls as part of audit exercise of a company. It is a new client. He has studied controls in place in various operational areas of the company.

After studying and gaining an understanding of such controls, he has decided to test few controls to actually see whether these are operating as intended by the management.

Till now, he has studied controls over inventories and bank.

Few of such controls are listed below:

<u><i>Nature of Control</i></u>	<u><i>Control description</i></u>
Control over inventories	Inventories of the company lying at each location should be insured.
Control over inventories	There should be inventory counts on a regular basis for each location of the company.
Control over Bank operations	Bank reconciliations are to be performed at regular intervals.

Based on above, answer the following questions: -

Q.1 Which of the following most appropriately describes test of control regarding insurance of inventories?

- a) Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. The sum insured and period of validity of policy are not relevant.
- b) Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure adequacy of sum insured by comparing it with value of inventories. Also ensure policy period has not expired.
- c) Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure policy period has not expired.
- d) Inspect insurance policies to verify that inventories at each location are insured for fire and burglary.

Q.2 Which of the following most appropriately describes test of control regarding inventory counts?

- a) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure.

- b) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count.
- c) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count and perform test count.
- d) Attend inventory count and perform test count.

Q.3 While testing control over bank reconciliations, it has been noticed that bank reconciliations are not being performed at regular intervals. Identify the most appropriate description of "control deficiency" in this regard: -

- a) Bank reconciliations are not being performed regularly as concerned staff is overburdened.
- b) Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors.
- c) Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors. It may result in misstatement of cash and bank balance in financial statements.
- d) Bank reconciliations are not being performed regularly as concerned staff is overburdened. These should be performed monthly and reviewed by senior accountant.

Q.4 Since the company is a new client, which of the following statements is most appropriate?

- a) There is reduced detection risk.
- b) There is increased detection risk.
- c) There is no effect on detection risk.
- d) Detection risk should be increased to lower audit risk.


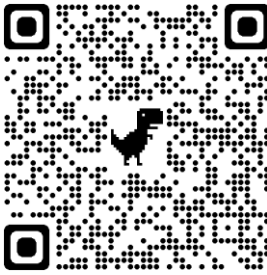


Q.5 Which of the following statements is most appropriate regarding auditor's response to assessed risk of a new client?

- a) More substantive procedures would require to be performed.
- b) Less substantive procedures would require to be performed.
- c) There is no effect on substantive procedures.
- d) There is no effect on substantive procedures as audit risk is low.

Answer

1. (b)
2. (c)
3. (c)
4. (b)
5. (a)

CA NOTES COMMUNITY NETWORK

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STUDY MATERIAL QUESTIONS

SA-500 - Audit Evidence

QUESTION-1

On perusal of financial statements of a company, auditor of company finds that notes to accounts contain aging of trade payables in accordance with requirements of Schedule III of Companies Act, 2013. The accountant of company is responsible for ensuring proper aging of trade payables included in notes to accounts.

The auditor wants to verify whether aging of trade payables made in financial statements is proper or not. Identify what he is trying to do.

ANSWER

Identifying Nature of Audit Procedure:

The auditor is verifying aging of trade payables. He is "reperforming" the control which was mandated by the management.

QUESTION-2

CA Soorya is conducting audit of an entity. During the course of audit, has made oral inquiries from head accountant regarding preparing of bank reconciliations every month as has been laid down by the management.

Discuss, whether inquiries as stated above would provide satisfaction to him that controls in respect of preparing bank reconciliations statements have operated effectively.

ANSWER

Procedures W.R.T. Evaluating Controls In Preparing BRS:

- 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. Mere inquiry does not lead to obtaining of sufficient appropriate audit evidence.
- In the instant case, CA Soorya should verify whether proper bank reconciliations have been carried out monthly as stipulated by management.
- Only then, he can be satisfied about operating effectiveness of controls in this regard.

QUESTION-3

A company has stipulated a control that reconciliations of its records showing quantitative details of its property, plant and equipment are carried out at regular intervals with physical verification of such items. The auditor has found that such reconciliations are being carried out as stipulated.

Discuss, whether above factor, increases reliability of other internally generated evidence within the company relating to existence of such items.

ANSWER

Reliability of Internal Evidences:

- The management is carrying out reconciliations of items contained in Property, Plant and Equipment records with physical verification of such items at regular intervals. It means that controls in this regard have operated effectively.
- 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.

QUESTION-4

State the assertions in respect of an item in the balance sheet under current assets reading as "cash in hand - 10,000".

ANSWER**Assertions W.R.T. Cash In Hand - 10,000**

- a) The firm concerned had 10,000 in hand in valid notes and coins on the balance sheet day;
- b) That the cash was free and available for expenditure to the firm; and
- c) That the books of account show a cash balance of identical amount at the end of the day on which the balance sheet is drawn up.

QUESTION-5

The auditor of JPJ Limited explained to the audit team members about the relationship between Audit Evidence and Opinion of Auditor.

Explain what relationship exists between Audit Evidence and Opinion of Auditor

ANSWER**Relationship Between Audit Evidence And Opinion Of Auditor**

- There exists a very important relationship between Audit Evidence and opinion of the Auditor.
- While conducting an audit of a company, auditor obtains audit evidence and with the help of that audit evidence obtained, he forms an audit opinion on the financial statements of that company.

QUESTION-6

An audit team member of the auditors of Genuine Limited was of the view that audit evidence obtained internally from within the company under audit are more appropriate from the reliability point of view as compared to audit evidence obtained externally as evidence obtained internally are obtained from the company whose audit is being conducted.

Give your views as auditor of Genuine Limited.

ANSWER**Reliability of Internal and External Evidences:**

- Audit evidence obtained externally is more appropriate from reliability point of view as compared to those which are obtained internally.
- The reason that audit evidence obtained externally is more appropriate from the point of view of reliability is that there is a very low risk that they can be altered or changed.

QUESTION-7

There was a Partnership Firm of Chartered Accountants VM and Associates. Mr. M, one of the partners of VM and Associates, while explaining to his audit team members about importance of audit evidence informed them about sufficiency and appropriateness of audit evidence.

Mr. A, one of the members of audit team of VM and Associates was of the view that sufficiency of audit evidence means simplicity of audit evidence and appropriateness of audit evidence means ease of obtaining audit evidence.

Explain whether sufficiency and appropriateness of audit evidence mean simplicity and ease of obtaining audit evidence.

ANSWER

Sufficiency and Appropriateness of audit evidence:

Sufficiency and Appropriateness of audit evidence does not mean simplicity and ease of obtaining audit evidence rather sufficiency of audit evidence is related to the quantity of audit evidence and appropriateness of audit evidence is related to quality of audit evidence.

QUESTION-8

While auditing the books of accounts of AB Limited for the financial year 2023-24, the auditor of the company used an audit procedure according to which complete documents and records of the company were checked in detail in order to obtain audit evidence.

Explain the audit procedure used by the auditor of Extremely Distinct Limited.

ANSWER

Identifying Nature of Audit Procedure:

The audit procedure used by auditor of AB Limited is known as Inspection because inspection is an audit procedure in which complete documents and records of a company are checked in detail for the purpose of obtaining audit evidence.

QUESTION-9

Discuss what is understood by “appropriateness” of audit evidence.

ANSWER

“Appropriateness” Of Audit Evidence

- Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its far as to reliability in providing support for the conclusions on which the auditor's opinion is based.
- Reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

QUESTION-10

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.

ANSWER

Advantages Of Using Audit Trail Feature In Accounting Software

- 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 F.S. or
- It is used as audit evidence to establish authentication and integrity of a transaction and help in maintaining record of system & 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 (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 used
- Audit trails involve costs. The cost is not only in terms of system expenditure but also in terms of soy time involved in analyzing data made available by audit trails.
- Systems which have a feature of audit trail inspires confidence in auditors. Since audit trails also enhance data security, these can be used by auditor while performing audit procedures thus increasing reliability of audit evidence obtained.

QUESTION-11

Give your assertions for the following items appearing in Balance Sheet of a Limited Company:

		Rs		Rs
a.	Cash in hand			10,000
b.	Investments			1,00,000
c.	Secured Loans			10,00,000
d.	Machinery:			
	Opening cost			
	Less: depreciation	13,00,000		
	Current depreciation	1,30,000		11,70,000

Answer**(i) Cash in Hand:**

Cash in hand is an item of current assets and it implies the following:

- that the company has 10,000 in hand in the form of currency notes and coins on the Balance Sheet date.
- that the cash is free and available for expenditure to the company.
- that the books of account show a cash balance of 10,000 as on balance sheet date.

(ii) Investments:

Investments is an item appearing in Balance Sheet either as non-current or as current investments and it implies as follows:

- that the company has made invested its surplus funds in the investments, i.e. its existence and ownership.
- that the investments are non-current or current investments, i.e. its classification.
- that the value of investments as on Balance Sheet date was 1,00,000, i.e. its valuation.

(iii) Secured Loan:

Secured loan is an item appearing in the Balance sheet either as long-term borrowing or as short-term borrowings and it implies as follows:

- that the company has borrowed, i.e. its existence.
- that the borrowing is secured one, i.e. its nature.
- that the borrowing as on Balance sheet date was 10,00,000, i.e. its valuation.

(iv) Machinery:

Machinery is an item appearing in the balance sheet as fixed asset under the heading non-current assets and it implies as follows:

- that the Company has certain Plant and Machinery as on balance sheet date, i.e. its existence and ownership.
- opening WDV is 13,00,000 and year end WDV was 11,70,000 after charging current year depreciation, i.e. its valuation and allocation of current year depreciation.

QUESTION-12

Most of the auditor's work informing the auditor's opinion consists of obtaining and evaluating audit evidence.

Explain.

ANSWER

Obtaining and Evaluating Audit Evidence:

- SA 500 "Audit Evidence" defines audit evidence as information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.
- 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 also include inspection, observation, confirmation, recalculation, reperformance 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.

QUESTION-13

What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor's judgement as to the sufficiency of audit evidence.

ANSWER

- 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.

QUESTION-14

While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?

ANSWER

Sampling Risk:

- SA 530 "Audit Sampling" deals with auditor use of sampling in performing audit procedures. However, due to application of sampling in audit procedures, there arise risk of sampling.

- Sampling Risk may be defined as 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:**
 - a) 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.
 - b) 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 old establish that initial conclusions were incorrect.

QUESTION-15

Write short notes on the following:

- a) Advantages of Statistical sampling in Auditing.
- b) Stratified sampling

ANSWER

Advantages of Statistical Sampling:

- 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.
- 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 -**
 - a) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
 - b) The sample selection is more objective and thereby more defensible.
 - c) The method provides means of estimating the minimum sample size associated with a specified risk & precision.
 - d) 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.
 - e) 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.
 - f) 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.

Stratified Sampling:

- This method involves dividing whole population in few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population. Number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.
- **Example:** Trade receivables balances may be divided as:
 - a) Balances in excess of 10,00,000;
 - b) Balances in the range of 5,00,001 to 10,00,000;
 - c) Balances in the range of 1,00,001 to 5,00,000;
 - d) Balances 1,00,000 and below.
- From these above groups the auditor may pick up different percentage of items from each of the group. From the top group i.e. balances in excess of 10,00,000, the auditor may examine all the items; from the second group 25% of the items; from the third group 10% of the items; and from the lowest group 2% of the items may be selected.

SA 610 - Using the Work of Internal Auditors

QUESTION-1

Moon Ltd. of which you are the statutory auditor, have an internal audit being conducted by an outside agency. State the factors that weigh considerations in opting to make use of direct assistance of the internal auditors for the purpose of statutory audit.

ANSWER

Using Direct Assistance Of Internal Auditor:

As per SA 610 "Using the Work of Internal Auditor" statutory auditor can take direct assistance of internal auditor subject to following conditions:

- The external auditor is not prohibited by law or regulation from obtaining direct assistance from internal auditors.
- There are no significant threats to the objectivity of the internal auditor.
- The internal auditor is sufficient competent to perform the proposed work.

Precautions To Be Taken While Using Direct Assistance:

- 1) External auditor shall not use internal auditors to provide direct assistance to perform procedures that:
 - a) Involve making significant judgments in the audit;
 - b) Relate to higher assessed risks of material misstatement;
 - c) Relate to work with which the internal auditors have been involved; or
 - d) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.
- 2) **Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:**
 - a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
 - b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.
- 3) The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with SA 220.

QUESTION-2

CA X, a practicing CA has been appointed as an internal auditor of Textile Ltd. He conducted the physical verification of the inventory at the year-end and handed over the report of such verification to CA Y, the statutory auditor of the Company, for his view and reporting.

Can CA Y rely on such report?

ANSWER

Evaluation of Internal Audit function so as to reply on work of Internal Auditor:

- SA 610 "Using the work of Internal auditors" deals with the external auditor's responsibilities regarding the work of internal auditors when the external auditor has determined, in accordance with SA 315 that the internal audit function is likely to be relevant to the audit.
- **For this purpose, external auditor is required to evaluate the following:**
 - A. **Objectivity of Internal Auditor:** Objectivity refers to the ability to perform without allowing bias to override professional judgments. Factors that may affect the external auditor's evaluation include the following:

- 1) Organizational status of the internal audit function.
 - 2) Conflicting responsibilities.
 - 3) Oversight functions of TCWG w.r.t. employment decisions related to the internal audit function.
 - 4) Constraints or restrictions placed on the internal audit function by management or TCWG.
- B. Level of Competency:** Competence of the internal audit function refers to the attainment of knowledge and skills to enable assigned tasks to be performed diligently.
- Factors that may affect the external auditor's determination include the following:**
- 1) Policies for hiring, training and assigning internal auditors to internal audit engagements.
 - 2) Adequate of technical training and proficiency in auditing of internal auditors.
 - 3) Knowledge of internal auditors w.r.t. entity's financial reporting and the applicable FRF.
 - 4) Membership of relevant professional bodies that oblige internal auditors to comply with the relevant professional standards.
- C. Systematic and Disciplined Approach:** Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:
- 1) Existence, adequacy and use of documented internal audit procedures.
 - 2) Existence of appropriate quality control policies and procedures for internal audit function.
- **Conclusion:**
- In the present case, if the statutory auditor is satisfied about the appropriateness of the verification, he can rely on the report but if he finds that the verification is not in order, he has to decide otherwise.
- The ultimate responsibility to express opinion on the financial statement is that of the statutory auditor.

QUESTION-3

A company has stipulated a control through its automated software that interest @ 12% p.a. is to be charged in case of those customers who fail to make payment within a month of a sales transaction.

The internal auditor of the company finds that during a certain period, software has failed to charge interest due to certain technical glitches. Does reporting of above situation fall in domain of internal auditor's work?

ANSWER

Scope of Internal Auditor's Work:

- One of the functions of internal auditor includes responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto.
- In the given case, internal auditor has found that controls relating to levying of interest have not operated. The system has not levied stipulated interest in respect of a certain period. It can result in loss of income for the company and improper financial reporting.
- Such a matter, definitely, falls in the domain of reporting by internal auditor.

QUESTION-4

CA Sukesh is external auditor of an entity. He comes to know that there is also an internal auditor in the entity. However, he finds that internal auditor is not reporting directly to higher echelons of the management. CA Sukesh has also assessed risk of material misstatement to be high.

Discuss, whether it would be proper for CA Sukesh to rely upon work of internal auditor extensively in above situation.

ANSWER

Relying upon work of Internal Auditors

- In the given case, the organizational status of internal audit function is not commensurate with his duties. He is not reporting directly to higher echelons of management. It shows that such a function is not given its due importance in entity.

- Since risk of material misstatements has also been assessed as high by CA Suresh, both the above factors suggest that he should not rely upon work of internal auditor extensively.

QUESTION-5

Discuss some of circumstances when work of the internal auditor cannot be used by external auditor.

ANSWER

Circumstances When Work Of The Internal Audit Function Cannot Be Used

External auditor shall not use work of internal audit function if he 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.

SA 530 - Audit Sampling

QUESTION-1

An auditor, while conducting audit of an entity, has selected samples based upon his personal experience and knowledge. Later on, it turns out that selected samples were not representative and it has led to faulty selection of samples. The auditor contends that samples were selected based upon his personal experience and knowledge.

Can auditor escape from his responsibility in this regard?

ANSWER

Auditor's Responsibility In Relation To Audit Sampling:

- In the provided situation, the auditor has selected samples based upon his personal experience and knowledge. It is a case of non-statistical sampling approach adopted by the auditor.
- Whatever may be the approach nonstatistical 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 auditor cannot escape his responsibility in this regard.

QUESTION-2

What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling".

ANSWER

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.
- **Samples Selection methods:**
 - a) **Random selection:** This method of sampling ensures that all items within a population stand an equal chance of selection by the use of random number tables or random number generators. The sampling units could be physical items, such as sales invoices or monetary units.
 - b) **Systematic selection:** The number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.
 - c) **Monetary unit sampling:** It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

- d) **Haphazard selection:** Samples are selected without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability. Haphazard selection is not appropriate when using statistical sampling.
- e) **Block selection:** It 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.

QUESTION-3

With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing.

ANSWER

Meaning of Audit Sampling:

- As per SA 530 on "Audit Sampling", the term Audit Sampling is defined as "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 is known as audit sampling".
- **Requirement of SA 530 as to Sample Design, Size and Selection of Items for Testing**
 - a) **Sample Design:** When designing an audit sample, the auditor shall consider the purpose of, and the characteristics of the population from which the sample will be drawn.
 - b) **Sample Size:** The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
 - c) **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.

SA 501 - Specific Considerations for Selected Items

QUESTION-1

JK Exports Ltd is a manufacturer exporter having its own production capacity and also gets the job work done through various job workers. The auditor of JK Exports Ltd. Considers that inventory held with job workers is material to the financial statements.

Required: Suggest the audit procedures in the given case

ANSWER

Audit Procedures w.r.t. Inventory lying with Third party:

When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

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

QUESTION-2

Parag India Ltd is a manufacturer of various FMCG (fast moving consumable goods) range of products. The company is having several cases of litigation pending in courts.

The auditor wanted to identify litigation and claims resulting to risk of material misstatements.

Required: Suggest the auditor with reference to SAs.

ANSWER

Audit Procedures w.r.t. Litigation and Claims:

- 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:
 - a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
 - b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
 - c) 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.

QUESTION-3

The audit procedures performed so far by auditor of a company indicate that there is a possibility that company has not disclosed all material litigation cases involving the company. Does such a situation warrant direct communication by auditor with external lawyer of the company?

ANSWER

Requirement of Direct Communication with External Lawyer:

- As per requirements of SA-501, 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, seek direct communication with the entity's external legal counsel.
- Situation as stated in question warrants direct communication with company's standing external lawyer.

QUESTION-4

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

ANSWER

Matters relevant in planning attendance at physical inventory counting:

- 1) Nature of inventory.
- 2) Stages of completion of work-in-progress.
- 3) The risks of material misstatement related to inventory.
- 4) The nature of the internal control related to inventory.
- 5) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- 6) The timing of physical inventory counting.
- 7) Whether the entity maintains a perpetual inventory system.
- 8) 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.
- 9) Whether the assistance of an auditor's expert is needed.

SA 505 - External Confirmations

QUESTION-1

During the financial year 2023-24, auditor of Healthy and Wealthy Limited asked a Trade Receivable to respond directly to the auditor whether or not the amount they were required to pay to Healthy and Wealthy Limited was 1,23,000. That trade receivable confirmed to the auditor of Healthy and Wealthy Limited, that they were required to

pay an amount of ₹ 1,23,000 to Healthy and Wealthy Limited. State and explain the type of Confirmation Request as required by the auditor.

ANSWER

Type of Confirmation Request:

- Situation as stated in the question is an example of Positive Confirmation Request because in Positive Confirmation Request the party confirms the auditor of a company whether such party agrees or
- whether such party disagrees with the information for which the confirmation is required by auditor of that company

QUESTION-2

CA Jignesh Desai is in midst of audit of a company. The company is fairly large one and has a well- functioning internal audit department. While considering sending out external confirmation requests to trade receivables outstanding as on date of financial statements, he has delegated the process of choosing trade receivables, designing requests and receiving responses from customers to internal audit department.

The responses are also received on the mail id of internal audit department.

Is approach of CA Jignesh Desai proper?

ANSWER

Control over External Confirmation Requests:

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

QUESTION-3

On reviewing schedule of trade receivables of a company, CA Mary finds that in respect of one outstanding balance, the CFO of the company is not willing to allow her to send external confirmation request due to the reason that sending out such request could spoil precariously placed business relations with the customer.

On further inquiry, she finds out that there is a dispute going on with the company relating to some quality issues of goods sent to the customer and matter is sub judice.

Efforts are also being made by the company for out of court settlement. Reviewing correspondence with the customer, she finds that issue is near resolution and no fraud risk factors exist.

Is unwillingness of CFO justifiable?

ANSWER

Management Refuses To Allow The Auditor To Send A Confirmation Request:

- In terms of requirements of SA 505, if management refuses to allow the auditor to send a confirmation request, the auditor shall inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness.
- A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. Further, fraud risk factors do not exist.
- Keeping in view, unwillingness of CFO is justifiable.

QUESTION-4

While conducting the audit of AB Ltd, the auditor K of KLM and Associates, Chartered Accountants observes that there are large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation request to few trade receivables, but the management refused the auditor to send confirmation request.

ANSWER

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
 - 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
 - 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 also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.

QUESTION-5

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.

ANSWER

Control over External Confirmation requests:

As per SA 505 "External Confirmations" 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.

SA 510 - Initial Audit Engagement - Opening Balances

QUESTION-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?

ANSWER

Reporting w.r.t. Opening Balances

- If the auditor is unable to obtain SAAE regarding the opening balances, he shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.
- If auditor concludes that the opening balances contain a misstatement that materially affects current period's F.S., and effect of the misstatement is not properly accounted for or not adequately presented or disclosed, he shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

QUESTION-2

What is the objective of the auditor with respect to the opening balances when conducting an initial audit engagement as per the relevant SA?

ANSWER

Objective of Auditor with respect to Opening Balances - in 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 FRF.

QUESTION-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?

ANSWER

Auditor's Procedures W.R.T. Opening Balances In Case Of Initial Audit Engagement:

- **Initial audit engagement is an engagement in which either:**
 - a) The financial statements for the prior period were not audited; or
 - b) The financial statements for the prior period were audited by a predecessor auditor.
- As per SA 510 "Initial Audit Engagements- Opening Balances", in case of initial audit engagement auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's F.S. 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:**
 - 1) Where the prior year F.S. were audited, perusing the copies of the audited F.S. including the other relevant documents relating to the prior period F.S.;
 - 2) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - 3) Performing specific audit procedures to obtain evidence regarding the opening of the balances.
- In the present case, 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.
- **Conclusion: - Approach of Mr. Pankaj is not correct. He needs to apply procedures as stated in SA 510.**

QUESTION-4

M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2023-24. 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?

ANSWER

Objective of Auditor with respect to Opening Balances - in 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 FRF.

SA 520 - Analytical Procedures

QUESTION-1

Define Analytical Procedures.

ANSWER

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.

QUESTION-2

CA Aarav wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2023-24. The rent amounts to 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 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.?

ANSWER

Using Analytical Procedures for verification of rental payments:

- If CA Aarav checks in detail the monthly rent payments, he may find that such payments are consistent with the rent agreement i.e. XYZ Ltd. paid 50,000 per month as rent and the same is getting reflected in the rent agreement. Here, CA Aarav 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 Aarav 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 Aarav 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.

QUESTION-3

Audit Evidence Analytical procedure involves analysis of relationship among financial and nonfinancial data. Explain with the help of an example as to how, the statutory auditor of ABC Ltd. will analyse such relationship with respect to the total wages paid by ABC Ltd. during the FY 2023-24.

ANSWER

Analyzing relationship w.r.t. Total Wages:

- As per SA 520, Analytical Procedures means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. The following example explains the analysis of relationship between financial and non-financial data while applying analytical procedures.

- The statutory auditor of ABC Ltd. has to verify the total wages paid by the company having factories in various states. He can verify the same by analyzing the relationship between wages per worker and total number of workers across all the factories.
- i.e. Total wages = Wages per worker x Total number of workers.
- Here wages per worker is financial data i.e. in and total number of workers is a number which is a non-financial data. Thus, the statutory auditor of ABC Ltd. is evaluating financial information i.e. total wages paid (in Rs) by analyzing the relationship between wages per worker (in) which is financial data and number of workers which is a non-financial data.

QUESTION-4

List various analytical procedures that can be used from below data:

Particulars	Client		Industry	
	2021-22	2022-23	2021-22	2022-23
Year				
Inventory Turnover	2.8	2.9	3.1	2.8
Gross Margin	22.5%	22.7%	23.6%	22.2%

ANSWER

Types of Analytical Procedures:

- Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques.
- Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.
- **Analytical Procedures may be segregated into the following major types:**
 - a) Comparison of client and industry data,
 - b) Comparison of client data with similar prior period data,
 - c) Comparison of client data with client-determined expected results,
 - d) Comparison of client data with auditor-determined expected results and
 - e) Comparison of client data with expected results, using non-financial data.

QUESTION-5

An auditor of a company intends to apply analytical procedures for verifying revenue.

Discuss any two analytical procedures which may be performed by auditor relating to revenues.

ANSWER

Analytical Procedures In Relation To Revenue

- (i) Comparing revenue of current year with previous year and investigating significant fluctuations
- (ii) Comparing revenue of current year with budgeted targets and investigating significant fluctuations.

QUESTION-6

Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit.

ANSWER

Use of Analytical Procedures in Planning Stage:

- 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.

QUESTION-7

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?

ANSWER

Techniques available while applying SAP:

- Trend analysis:** Trend analysis is most commonly used technique which involves comparison of current data with the prior period balance or with a trend in two or more prior period balances.
 - **Example:** Auditor may compare the salary paid during the year under audit with the salary paid for several earlier years. There may be some percentage increase in the salary expense over the years. However, an unusual increase may indicate that fraudulent payments are being made to fake employees.
 - Ratio analysis:** Ratio analysis involves analyzing revenue and capital items forming part of balance sheet and profit and loss account. Ratios can also be compared over a period of time or to the ratios of other entities within the 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. These tests are generally more applicable to income statement accounts and certain accrual or pre-payment 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).
- ❖ 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.

QUESTION-8

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"?

ANSWER

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:***
 - 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.
 - 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.

QUESTION-9

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".

ANSWER

Factors Determining Extent Of Reliance On Analytical Procedures (SA-520)

The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

Factors Affecting The Reliability Of Data On Which Analytical Procedures Are To Be Performed:

As per SA 520 "Analytical Procedures" facts that may affect the reliability of data are:

a) **Source of the information available.**

For example, information may be more reliable when it is obtained from independent sources outside the entity;

b) **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;

c) **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

d) **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.

SA 550- Related Parties

QUESTION-1

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.

ANSWER

Nature of Related Party Relationships & Transactions:

- 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:**
 1. 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.
 2. Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
 3. 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.

MCQS BASED QUESTIONS

- (1) Which of the following is not one of functions of internal auditor of an organization?**
- (a) Performing assurance activities
 - (b) Performing consulting activities to improve governance of organization
 - (c) Performing risk management activities
 - (d) Expressing independent opinion on financial statements of organization
- (2) An auditor finds during course of an audit that the entity has entered into many related party transactions. Which of the following statements is true?**
- (a) The risk that management may override controls in respect of related party transactions is lower.
 - (b) The risk that management may override controls in respect of related party transactions is higher.
 - (c) There is no effect on the risk that management may override controls in respect of related party transactions.
 - (d) Risk of overriding of controls by management has no relationship at all with related party transactions.
- (3) Which of the following is not an objective of a company's policies for ensuring "internal financial controls"?**
- (a) Efficient conduct of business
 - (b) Safeguarding of assets
 - (c) Prevention and detection of frauds and errors
 - (d) Assessing audit risk
- (4) Which of the following is not an advantage of statistical sampling?**
- (a) Sample size does not increase in proportion to size of area tested.
 - (b) Sample selection is more objective.
 - (c) It provides a means of deriving a calculated risk and corresponding precision.
 - (d) In case of verifying compliance with specific legal requirements, it is suitable.
- (5) A company auditor receives external confirmation from an entity to whom company has sold goods. The said amount is properly classified in financial statements of company. Which of the following statements is not true in this regard?**
- (a) It shows that said trade receivable exists.
 - (b) It shows that said trade receivable is properly valued.

- (c) It shows that company has a right to said trade receivable.
- (d) It shows that amount of said trade receivable has been recorded in proper account.

Answers to the MCQs based Questions

1. d 2. b 3. d 4. d 5. b

TRUE/FALSE QUESTIONS

QUESTION-1

Non-Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

ANSWER

Statement is correct.

- Approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics is statistical approach.
- Audit Evidence Non-statistical sampling approach does not have characteristics of random selection and use of probability theory.

QUESTION-2

Sample need not be representative

ANSWER

Statement is incorrect.

- Sample need to be representative of entire population, irrespective of approach non-statistical or statistical sampling.
- Samples must be closely similar to the whole population although not necessarily exactly the same.

QUESTION-3

The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

ANSWER

Statement is incorrect.

- Stratification implies conversion of heterogeneous population into homogeneous groups known as strata.
- 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.

QUESTION-4

When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.

ANSWER

Statement is incorrect.

Whatever may be the approach of 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.

QUESTION-5

Stratified Sampling is used for homogeneous population.

ANSWER**Statement is incorrect.**

- Stratified sampling is used when the population is diversified i.e., heterogeneous.
- The population is divided into sub-population having similar characteristics. Sample are then chosen from these sub populations which are called as Stratum.
- Therefore, stratified sampling is not useful in case of homogeneous population.

QUESTION-6

Non-statistical sampling is considered to be more scientific than the statistical sampling.

ANSWER**Statement is incorrect.**

Statistical sampling uses scientific method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non-statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.

QUESTION-7

In case of Statistical sampling, auditor's bias in choosing sample is involved.

ANSWER**Statement is incorrect.**

- Statistical sampling uses scientific method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected.
- In the non-statistical sampling, auditor's judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in Non-statistical sampling and not Statistical.

QUESTION-8

The statutory auditor of the company can apply analytical procedures to the standalone financial statements of a company only and not to the consolidated financial statements.

ANSWER**Statement is incorrect.**

Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

QUESTION-9

According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to 100% of items within a population of audit relevance.

ANSWER**Statement is incorrect.**

As per SA 530 "Audit sampling", 'audit sampling' refers to 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.

QUESTION-10

A modelling tool constructs a statistical model from financial data only of prior accounting periods to predict current account balances.

ANSWER

Statement is incorrect.

A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances.

QUESTION-11

While designing audit procedures to address an inherent risk or "what can go wrong", auditor should consider the nature of the risk of material misstatement in order to determine if a substantive to analytical procedure can be used to obtain audit evidence.

ANSWER

Statement is correct.

- While designing audit procedures to address an inherent risk or "what can go wrong", auditor should consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence.
- When inherent risk is higher, auditor need to design tests of details to address the higher inherent risk. In case of higher inherent risk, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.

QUESTION-12

During the audit process, the auditor can easily identify all mistakes or manipulations that may exist in the accounts through routing checking processes.

ANSWER

Statement is incorrect.

Auditor cannot be depended on routine checks to disclose all the mistakes or manipulation that may exist in accounts. Certain other procedures like trend and ratio analysis also have to be applied in addition to routine checks.

QUESTION-13

When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.

ANSWER

Statement is incorrect.

Sample should be selected in such a manner that it is representative of the population from which the sample is being selected. Whatever may be the approach non-statistical or statistical sampling, the sample must be representative.

QUESTION-14

Sufficiency is the measure of the quantity of audit evidence.

ANSWER

Statement is correct.

- 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).

QUESTION-15

The objectives and scope of internal audit functions are restricted to activities relating to evaluation of internal control only.

ANSWER

Statement is Incorrect.

- 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.
- From the above, it can be concluded that the objective and scope of internal audit function are not restricted to activities relating to evaluation of control only.

QUESTION-16

If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall include an Emphasis of Matter paragraph in the auditor's report.

ANSWER

Statement is incorrect.

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.

QUESTION-17

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.

ANSWER

Statement is incorrect.

Assertions refers to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

QUESTION-18

In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater.

ANSWER

Statement is correct.

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

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

QUESTION-19

In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.

ANSWER

Statement is incorrect.

- In case of stratified sampling, the conclusions are drawn on the stratum.
- The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation.
- Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.

QUESTION-20

When auditor inquires the management as part of the audit procedures it should be formal written form only and not informal oral inquiries.

ANSWER

Statement is incorrect.

When auditor inquires the management as part of audit procedures such inquiries may range from formal written inquiries to informal oral inquiries.

QUESTION-21

Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

ANSWER

Statement is incorrect.

Entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions, is known as Population.

QUESTION-22

Inquiry alone is sufficient to test the operating effectiveness of controls.

ANSWER

Statement is incorrect.

Inquiry along with other audit procedures (for example observation, inspection, external confirmation etc.) would only enable the auditor to test the operating effectiveness of controls. Inquiry alone is not sufficient to test the operating effectiveness of controls.

QUESTION-23

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.

ANSWER

Statements is incorrect.

Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.

QUESTION-24

Purchase invoice is an example of internal evidence.

ANSWER

Statement is incorrect.

- Internal evidence is one that has been created within the client's organization.
- Purchase invoice is external evidence as it originates from outside the entity.

QUESTION-25

Analytical procedures are used in all stages of audit by experienced auditors.

ANSWER

Statement is correct.

Experienced auditors use analytical procedures in all stages of the audit. 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.

QUESTION-26

Audit evidence obtained through observation of the application of a control is less reliable than audit evidence obtained by inquiry about the application of a control.

ANSWER**Statement is incorrect.**

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).

QUESTION-27

The higher the auditor's assessment of the risk of material misstatement, the smaller the sample size needs to be.

ANSWER**Statement is incorrect.**

- The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be. The auditor's assessment of the risk of material misstatement is affected by inherent risk and control risk.
- Therefore, in order to reduce audit risk to an acceptably low level, the auditor needs a low detection risk and will rely more on substantive procedures. The more audit evidence that is obtained from tests of details (that is, the lower the detection risk), the larger the sample size will need to be.

QUESTION-28

Systematic sampling means dividing heterogeneous population into homogeneous sub-population, where samples are drawn from each sub population.

ANSWER**Statement is incorrect.**

- Stratification means dividing heterogeneous population into homogeneous sub-population, where samples are drawn from each sub-population. Systematic sampling is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval,
- **for example**, 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.

QUESTION-29

Low acceptable sampling risk requires larger sample size.

ANSWER**Statement is correct.**

Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.

QUESTION-30

Reasonableness test rely only on the events of the prior period like other analytical procedures.

ANSWER**Statement is incorrect.**

Unlike trend analysis, Reasonableness test does not rely on events of prior periods, but upon non- financial data for the audit period under consideration.

QUESTION-31

As per SA 520 the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among financial data only.

ANSWER

Statement is incorrect.

SA 520 "Analytical Procedures" defines the term analytical procedures as evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

QUESTION-32

In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.

ANSWER:

Statement is incorrect.

In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusions only on the respective stratum from where they are drawn and not the whole population.

QUESTION-33

Auditor can depend on routine checks to disclose all the mistakes or manipulation that may exist in accounts.

ANSWER

Statement is incorrect.

- Auditor cannot be depended on routine checks to disclose all the mistakes or manipulation that may exist in accounts.
- Certain other procedures like trend and ratio analysis also have to be applied in addition to routine checks.

QUESTION-34

Only purpose of analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures.

ANSWER

Statement is incorrect.

Analytical procedures are being applied:

- To obtain relevant & reliable audit evidence when using substantive analytical procedures; &
- To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the F.S. are consistent with auditor's understanding of the entity.

QUESTION-35

Analytical Procedures are required in the planning phase only.

ANSWER

Statement is incorrect.

Analytical Procedures are applied not only during planning phase but also applied

- During the audit and
- Near the completion of audit.

QUESTION-36

Ratio analysis is useful in analyzing revenue and expense account only.

ANSWER

Statement is incorrect.

Ratio analysis is useful for analyzing asset and liability accounts as well as revenue and expense accounts.

QUESTION-37

The level of sampling risk that the auditor is willing to accept will not affect the sample size.

ANSWER**Statement is incorrect.**

- As per SA 530, "Audit Sampling" 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.

QUESTION-38

Statistical sampling being more scientific and without personal bias will always be appropriate to use under all circumstances.

ANSWER**Statement is incorrect.**

- Statistical sampling 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. Under some audit circumstances, statistical sampling methods may not be appropriate.
- The auditor should not attempt to use statistical sampling when another approach is either necessary or will provide satisfactory information in less time or with less effort. For instance, when exact accuracy is required or in case of legal requirements etc.

QUESTION-39

SA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit, that assist the auditor in preparation of the financial statements.

ANSWER**Statement is incorrect.**

SA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.

QUESTION-40

R Ltd. has asked for email responses for the purpose of external confirmation. The auditor, however, feels that external confirmation received electronically involves the risk of its reliability.

ANSWER**Statement is correct.**

- SA 505, "External Confirmations", responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect.
- Hence R Ltd. Should avoid using email responses as evidence for external confirmation.

QUESTION-41

While auditing the books of account of ABC Ltd., the auditor of the company looked at the inventory counting process to obtain audit evidence. In the present case, audit procedure used by the auditor is known as "Inspection".

ANSWER**Statement is incorrect.**

The audit procedure used by the auditor of ABC Ltd. is known as "observation". Whereas inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

QUESTION-42

In case of stratified sampling, the conclusions are drawn on the stratum.

ANSWER

Statement is correct.

- In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation.
- Hence the samples are used to derive conclusions only on the respective stratum from where they are drawn and not the whole population.

QUESTION-43

Stratified Sampling involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them.

ANSWER

Statement is correct.

- Stratified Sampling 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 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.

QUESTION-44

Ratio analysis is a 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.

ANSWER

Statement is Incorrect.

- Trend analysis is a 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.
- Ratio analysis involves analyzing revenue and capital items forming part of balance sheet and profit and loss account.

QUESTION-45

An auditor is not concerned with consistency of accounting policies relating to opening balances.

ANSWER

Statement is incorrect.

As per SA 510 "Initial Audit Engagement - Opening Balances", the auditor shall obtain sufficient appropriate audit evidence about:

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

QUESTION-46

Audit evidence obtained from external confirmation is always reliable.

ANSWER**Statement is incorrect.**

- As per SA 505 "External Confirmations" depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity.
- All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium.

QUESTION-47

Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time.

ANSWER**Statement is incorrect.**

As per SA 520 "Analytical Procedures" substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable. A predictable relationship is one that may reasonably be expected to exist and continue over time.

QUESTION-48

Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

ANSWER**Statement is correct.**

- 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.

QUESTION-49

The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific.

ANSWER:**Statement is correct.**

- The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific. The expected degree of objectivity cannot be assured in non-statistical sampling because the risk of personal bias in selection of sample items cannot be eliminated.
- The closeness of the qualities projected by the sample results with that of the whole population cannot be measured because the sample has not been selected in accordance with the mathematically based statistical techniques.

QUESTION-50

If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall include an Emphasis of Matter paragraph in the auditor's report.

ANSWER:**Statement is incorrect.**

As per SA 510, "Initial Audit Engagements - Opening Balances", 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.

QUESTION-51

Statistical sampling has narrower application where a population to be tested consists of a large number of similar items.

ANSWER

Statement is incorrect.

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.

QUESTION-52

If an entity has a known number of employees at fixed rates of pay throughout the period, there would be more need to perform tests of details on the payroll.

ANSWER

Statement is incorrect.

If 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.

QUESTION-53

External confirmation procedures are restricted to the items of addressing assertions associated with account balances & their elements only.

ANSWER

Statement is incorrect.

- External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items,
- ***For example***, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties.

QUESTION-54

Positive Confirmation request is a request where the confirming party respond only if it disagrees with the information provided in the request.

ANSWER:

Statement is incorrect.

- As per SA 505 "External Confirmations" a request where the confirming party respond only if it disagrees with the information provided in the request, is known as Negative Confirmation request.
- Positive Confirmation request is 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.

QUESTION-55

The scope of work of an internal auditor may extend even beyond the financial accounting.

ANSWER

Statement is Correct.

As per SA 610 "Using the Work of Internal Auditor" the scope of internal audit function may include:

- Monitoring of internal control

- Examination of financial & operating information
- Review of operating activities
- Review of compliance with laws & regulations
- Risk management
- Governance

QUESTION-56

The method which involves dividing the population into group of items is known as block sampling.

ANSWER

Statement is incorrect.

- Dividing the population into groups of items is known as Cluster sampling.
- Block sampling involves the selection of a defined block of consecutive items.

QUESTION-57

Inquiry alone provides sufficient audit evidence of the absence of a material misstatement at the dir assertion level and of the operating effectiveness of controls.

ANSWER

Statement is incorrect.

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.

QUESTION-58

All entities that are under common control by a state (i.e., national, regional or local government) are considered related party.

ANSWER

Statement is incorrect.

As per SA 550 "Related Parties", entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

QUESTION-59

When inventory under the custody and control of a third party is material to the financial statements, the auditor can obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management.

ANSWER

Statement is incorrect.

When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and

condition of that inventory by performing one or both of the following:

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

QUESTION-60

Inquiry alone ordinarily does not provide sufficient audit evidence.

ANSWER

Statement is correct.

- Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, Reperformance 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.

QUESTION-61

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, the auditor need not seek direct communication with the entity's external legal counsel.

ANSWER

Statement is incorrect.

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.

QUESTION-62

Audit evidence obtained from external confirmation is always reliable.

ANSWER

Statement is incorrect.

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

CASE SCENARIO

Case Study - 1

CA Drishti Khandelwal is conducting audit of a company engaged in manufacturing of towels and bedspreads. The company is having its own manufacturing set-up. However, it also gets some manufacturing processes outsourced from third parties. The company has three locations having substantial quantities of inventories in the same city. Besides, due to outsourcing of some processes, inventories are also held in premises of third parties in the same city. As part of audit procedures, she is performing many audit procedures required by different Standards on Auditing.

In particular, she is attending physical inventory count process of the company at year end in accordance with requirements of SA 501. The inventory of the company includes raw materials consisting mainly of natural and dyed yarns, work in process in different stages of manufacturing and finished stocks of towels and bedspreads.

She is also planning sending confirmations to parties to whom the company has sold goods. On reviewing trade receivables list, she finds that the list also contains large number of parties having small balances. She further finds that these receivables have arisen due to sale of bedspreads to small time retailers and possibility of difference in balances as per company's records and as per records of these small-time retailers is low. Risk of misstatements in relation to trade receivables has been assessed as low. Besides, there is nothing to suggest that small-time retailers would disregard such requests.

While conducting audit, she is testing controls operating in the company. She is also conducting tests of various items of income and expenditure as well as balances appearing in balance sheet. She intends to rely upon sampling extensively.

➤ ***Based on above description, answer the following questions:***

Q.1 Which of the following statements is most appropriate regarding inventory count by auditor in accordance with SA 501?

- a) She should inspect the inventory to ascertain its existence and condition at all locations, observe how company personnel are carrying out count procedures and perform test counting.
- b) She should inspect the inventory to ascertain its existence at all locations, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.
- c) She should inspect the inventory to ascertain its existence at selected location, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.
- d) She should inspect the inventory to ascertain its existence and condition at all locations and perform discounting of each and every item.

Q.2 As regards inventories lying with third parties, which of following statements meets requirements of SA 501?

- a) She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company as well as request third parties to allow her to inspect inventories held by them. Both requirements are necessary to be complied with.
- b) She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these or both is required for purposes of SA 501.
- c) There is no obligation cast upon an auditor in respect of inventories lying with third parties.
- d) She should request confirmation from third parties regarding quantity, condition and value of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these is sufficient for purposes of SA 501.

Q.3 Keeping in view description regarding trade receivables, identify the most appropriate statement in context of SA 505?

- a) She should not plan & design confirmation requests for large number of parties having small balances.
- b) She should plan and design positive confirmation requests for large number of parties having small balances.
- c) She should plan and design positive confirmation requests for large number of parties having small balances and meticulously Analyse exception rate
- d) She should plan and design negative confirmation requests for large number of parties having small balances.

Q.4 As regards sampling, which of the following statements is most appropriate in terms of requirements of SA 530?

- a) Sampling is used in tests of transactions as well as tests of controls.
- b) Sampling is used in tests of balances as well as tests of controls.
- c) Sampling is used in tests of details.
- d) Sampling is used in tests of details as well as tests of controls.

Q.5 Since she intends to rely upon sampling extensively, which of the following statements is true about sampling risk?

- a) Sampling risk can be eliminated.
- b) Increase in sampling risk would lead to decrease in detection risk.
- c) Decrease in sampling risk would lead to increase in detection risk.
- d) Sampling risk will always be in existence.

Answer

1. (a)
2. (b)
3. (d)
4. (d)
5. (d)

Case Study - 2

Financial statements of a firm have been put up for audit before CA Manushi. Ongoing through financial statements, she wants to verify assertions contained in financial statements and has planned certain procedures for carrying out detailed checking.

- (A) She plans to verify some major bills debited in "Machinery repair" account. The purpose of it is to ensure that bills are entered correctly and their classification is proper.
- (B) She plans to verify that all balances appearing under trade payables are genuine and not fake.
- (C) She plans to compare amount of wages paid in current year and last year. It is also planned to verify relationship between the number of employees and wages paid in both years.
- (D) She is of the view that it is necessary to examine title deeds of "land" appearing in financial statements of the firm.
- (E) The firm is engaged in export of goods to Europe. The sales invoices raised in Euros are converted into Indian rupees as per applicable norms.

➤ **Based on above description, answer the following questions:**

Q.1 As regards description given regarding verification of bills debited in "Machinery repair" account, identify what she intends to perform?

- a) Tests of Controls
- b) Tests of transactions
- c) Tests of balances
- d) Risk assessment procedures

Q.2 Identify which type of assertion she intends to focus when she wants to ensure genuineness of trade payables.

- a) Occurrence
- b) Cut-off
- c) Existence
- d) Accuracy

Q.3 As regards comparison of wages of current year and last year and comparison of relationship between the number of employees and wages paid in both years, identify what she is trying to do?

- a) She is intending to perform tests of details.
- b) She is intending to perform tests of transactions.
- c) She is intending to perform tests of balances.
- d) She is intending to perform substantive analytical procedures.

Q.4. In case of examination of title deeds of "land", which of the following fits into most appropriate description of such an audit procedure?

- a) Observation
- b) Inspection
- c) External confirmation
- d) Enquiry

Q.5 She wants to verify whether conversion of foreign currency into Indian rupees is proper or not. Identify what she is trying to do?

- a) Reperformance
- b) Recalculation
- c) Observation
- d) Inspection

Answer - Case Study 2

1 (b)

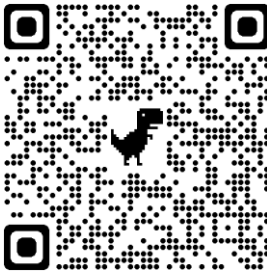

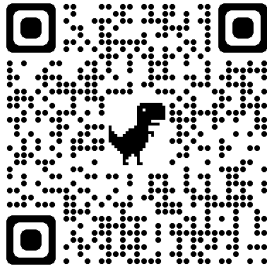

2 (c)

3 (d)

4 (b)

5 (b)

CA NOTES COMMUNITY NETWORK

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TEAM CNC

STUDY MATERIAL QUESTIONS

QUESTION-1

Various ratios of current year and preceding year are disclosed in financial statements of a company in accordance with requirements of Schedule III of Companies Act, 2013. Discuss requirements of law in this regard (Do not list out names of ratios).

ANSWER

Requirements Of Companies Act, 2013 As To Disclosure Of Ratios

- A company has to disclose various ratios in its F.S. in accordance with requirements of Schedule III of Companies Act, 2013.
- Company shall also explain the terms included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

QUESTION-2

How will you vouch/verify the following: Receipt of capital subsidy.

ANSWER

Receipt of Capital Subsidy

- (1) Check the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- (2) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.
- (3) 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.
- (4) Check relevant entries for receipt of subsidy.
- (5) 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.

QUESTION-3

How will you vouch/verify the following: Foreign travel expenses.

ANSWER

Vouching of 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 authorized 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 authorization 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 AS 11 "The Effects of Changes in Foreign Exchange Rates".

QUESTION-4

How would you vouch/verify the following: Advertisement Expenses.

ANSWER**Vouching Of 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.

QUESTION-5

State the disclosure requirements in respect of Statement of profit and loss as per Schedule III of Companies Act, 2013, in case of Employee benefits expenses.

ANSWER**Disclosure requirements w.r.t. employee benefit expenses as per Schedule III:**

Schedule III requires that a Company shall disclose by way of notes additional information regarding the employee benefit expenses as:

- salaries and wages,
- contribution to provident and other funds,
- expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP),
- staff welfare expenses

QUESTION-6

A company is engaged in manufacturing of fabrics from yarn purchased from different suppliers. Occasionally, it also manufactures fabrics tailor made in accordance with requirements of certain mills from yarn received from these mills. The company raises bill of its labour charges only on mills for converting yarn into fabrics.

The auditor of company tries to ensure that stocks of the company as at year end do not include stocks pertaining to these mills. Which assertion auditor tries to verify in above situation? How he can ensure that?

ANSWER**Identification Of Assertions Examined**

- Auditor is trying to verify assertion relating to "Rights and Obligations". He is verifying that the company owns or controls the inventory recorded in the financial statements.
- Any inventory held by company on behalf of another entity has not been recognized as part of inventory.
- This can be achieved by verifying stock records pertaining to goods received from mills and sent back to mills after carrying out necessary operations. Besides, agreements with such mills may also be verified.

QUESTION-7

How will you vouch or verify: Goods sent on consignment.

ANSWER**Verification Of Goods Sent On Consignment**

- a) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.
- b) 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.

- c) 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.
- d) Ensure that 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 NRV is lower, the inventory in hand of the consignee should be valued at NRV. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.
- e) See that goods in hand with the consignee have been shown separately under the head inventories.

QUESTION-8

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 31.03.2024.

What audit procedures should the statutory auditor of the company perform?

ANSWER

Audit Procedure To Establish The Ownership Rights

1. Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
2. Evaluate the consigned goods.
3. Examine client correspondence, sales and receivables records, purchase documents.
4. Determine existence of collateral agreements.
5. Review consignment agreements.
6. Review material purchase commitment agreements.
7. 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.
8. For instances of inventory held by third party, 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.

QUESTION-9

You are the statutory auditor of Jupiter Ltd. for the FY 2023-24. 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?

ANSWER

Disclosures W.R.T. Capital-Work-In Progress

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

CWIP ageing schedule

(Amount in Rs)					
	Amount in CWIP for a period of				Total*
CWIP	Less than 1 year years	Less than 1-2	Less than 2-3	More than years 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 Rs)				
	To be completed in			
CWIP	Less than 1 year years	Less than 1-2	Less than 2-3	More than years 3 years
Projects 1				
Projects 2				

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

QUESTION-10

A company has availed cash credit facility of 2 Crore (0/s balance 2 Crore as at year end) from a bank for meeting its working capital requirements against security of stocks and debtors and guaranteed by directors of the company.

Discuss, how the above cash credit facility, would be classified and disclosed in financial statements of company.

Answer

Classification and Disclosure of Cash credit Facility in Financial Statements:

- Cash Credit Facility shall be shown under head "Borrowings" and classified as short-term secured borrowings specifying nature of security. The above said outstanding amount shall be further sub- classified under heading "Loans repayable on Demand" from Banks.
- As per requirements of Schedule III of Companies Act, 2013, where loans have been guaranteed by directors or others, aggregate amount of such loans under each head shall be disclosed.

QUESTION-11

An auditor of a company is focusing upon revenues of a company. In this regard, besides performing usual detailed checking of sales, he wants to perform substantive analytical procedures in respect of sales.

Discuss how he can perform such procedures.

ANSWER

Substantive Analytical Procedures In Respect Of Sales:

- Substantive analytical procedures in respect of sales will consist of sales trend analysis, comparison with previous accounting period, category-wise sales analysis, any analysis the auditor may find relevant and most important of all, building a sales expectation and comparing that with the client's sales records.
- The auditor will need to know the sales prices of the products or services over the year, monthly average sales price per product or service, discount policy.

QUESTION-12**How will you vouch/verify: Provision for Tax.****ANSWER****Payment of Taxes:**

1. 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.
2. Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
3. Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.
4. Compute tax payable as per the latest applicable rates in the Finance Act.
5. Ensure that overall provisions on the date of the balance sheet is adequate having regard to levis current year provision, advance tax paid, assessment orders, etc.
6. Ensure that the requirements of AS 22 on "Accounting for Taxes on Income" have been appropriately followed for the period under audit.

QUESTION-13

MNO & Associates are the statutory auditor of Venus Ltd. for the FY 2023-24. During the course of audit, one of the audit team members, Mr. Viaan noticed that the company has made loans totaling 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 bas disclosure requirements with respect to such loans required by Schedule III to the Companies Act, 2013. What should Mr. Manik advise Mr. Viaan?

ANSWER**Disclosure Requirements With Respect To Loans**

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:

- repayable on demand or
- without specifying any terms or period of repayment

Type of Borrower	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		

QUESTION-14

While verifying depreciation charged to statement of profit and loss account of a company, it is noticed by auditor that one new machinery was purchased and installed in month of April. The necessary trials were carried out and machinery was ready for use in April itself.

However, owing to lack of orders in the market, the said machinery was put into actual operation from 1st October. The company has, accordingly, provided depreciation in its books on this machinery w.e.f. 1st October. Is above recording of deprecation by company proper in its books?

ANSWER

- Depreciation of an asset begins when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.
- Depreciation on asset is charged on asset from the date when it is ready for use and not from date of actual usage.
- Hence, recording of depreciation by company w.e.f. 1st October is not proper.

QUESTION-15

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.

ANSWER

Issue Of Shares At Premium

- Where a company has issued shares at a premium, whether for cash or otherwise, aggregate amount of the premium received on those shares shall be transferred to securities premium account.
- **As per Sec. 52 of Companies Act, 2013 the securities premium account may be applied by the company for the following purposes:**
 - a) issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - b) writing off the preliminary expenses of the company;
 - c) writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - d) 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 u/s 68.
- 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.

QUESTION-16

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.

ANSWER

Verification of Addition to Property, Plant & Equipment:

- (1) 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 of respective entity.
- (2) 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.
- (3) The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date.
- (4) In case the entity has given such immovable property as security for any borrowings and the original title deeds are not available with the entity, 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 immovable property as security.
- (5) In addition, the auditor should also verify the register of charges, available with the entity to assess bonbons the PPE that has been given as security to any third parties

QUESTION-17

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?

ANSWER**Disclosure Requirement With Respect To The Ageing Schedule Of The Trade Receivables**

- 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 :***

	(Amount in Rs)					
Particulars	Outstanding for following periods from due date of payment [#]					Total
(a) Undisputed Trade receivables - considered good	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	
(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.

QUESTION-18

Write the audit Procedure for verification of existence of Trade Receivables.

ANSWER

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

- 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.

- b) 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.
 - c) If any large balance is due for a long time, auditor should ask for reasons and justification for the same.
 - d) 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.
 - e) The auditor should maintain strict control to ensure the correctness and proper dispatch 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.
 - f) 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.
 - g) Where no reply is received, the auditor should perform alternate procedures regarding the balances.
 - h) Agreeing the balance to cash received subsequently;
 - i) 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)
 - j) 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.
 - k) Check that receivables for other than sales or services are not included in the list.
 - l) 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.**

QUESTION-19

How will you vouch/verify the following: Goods sent out on sale or return basis?

ANSWER

Vouching Of Goods Sent On Sale Or Return Basis

- a) Check maintenance of separate memoranda records of goods sent out on sale or return. Only after approval from customer, personal account of customer is debited and the sales account is credited.
- b) Ensure that the price of such goods is unloaded from the sales account and the debtor's record before the approval from customer.
- c) In respect of the goods for which approval period has expired, ensure that either goods have been received back or customer's account have been debited.
- d) In respect of the goods for which approval period has not expired till the close of the year and lying with the party, ensure that cost of such goods has been included in the closing stock.

QUESTION-20

How will you vouch/verify: Borrowings from banks?

Answer

Verification Of Borrowings 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:

- a) Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) to 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.
- b) 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 RoC and recorded in the Register of charges.
- c) Verify the authority under which the loan or draft has been raised. In the case of a company, only the BoD is authorised to raise a loan or borrow from a bank.
- d) Confirm, in the case of a company, that the restraint contained in Sec. 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.
- e) 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.

QUESTION-21**How will you vouch/verify: Provision for income tax.****Answer**

- a) 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.
- b) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
- c) Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.
- d) Compute tax payable as per the latest applicable rates in the Finance Act.
- e) 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.
- f) Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under audit.

QUESTION-22**How will you vouch/verify: payment of taxes?****Answer**

- 1) 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
- 2) receipted challan.
- 3) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
- 4) 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.
- 5) 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.
- 6) 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.
- 7) 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.

QUESTION-23**How would you vouch/verify the following: Sale of Scrap?****ANSWER****Vouching of Sale of Scrap:**

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

MCQS BASED QUESTIONS

1. An auditor is verifying purchases to ensure their genuineness. Consequently, he is also trying to verify that no fake "trade payables" are present in financial

statements. Which assertions concerning purchase transactions and trade payables respectively are being verified by auditor?

- (a) Occurrence; Existence
- (b) Occurrence; Completeness
- (c) Existence; Occurrence
- (d) Completeness; Occurrence

2. Which of the following statement is most appropriate as regards to disclosure of goods in transit in financial statements of a company?

- (a) No separate disclosure of goods in transit is required.
- (b) Disclosure of total goods in transit under head of inventories is required.
- (c) Disclosure of goods in transit under each sub-head of inventories is required.
- (d) Disclosure of goods in transit for raw material and finished goods is required.

3. Sweat Equity shares are issued by a company at a discount or for consideration other than cash to its:-

- (a) Directors only
- (b) Clients only
- (c) Directors or employees
- (d) Auditors only

4. Which of the following is not an element of cost of an item of machinery included under head "Property, Plant and Equipment"?

- (a) Installation costs
- (b) Freight cost of bringing the item to its location
- (c) Inaugural costs
- (d) Employee benefit cost for making such an item suitable for production

5. Which of the classification is not required by a company in respect of its "Cash and cash equivalents?"

- (a) Balance with Banks
- (b) Balance with scheduled banks
- (c) Cash on hand
- (d) Cheques on hand

Answers to the MCQs based Questions

1. a 2. c 3. c 4. c 5. b

TRUE/FALSE QUESTIONS

QUESTION-1

Tangible assets are depreciated when the asset is actually put to active use.

ANSWER

Statement is incorrect.

- Depreciation is a fall in value of asset due to obsolescence, usage and effluxion of time.
- Therefore, depreciation is charged when the asset is ready for use. Active use of asset is not a mandatory criteria for charge of depreciation.

QUESTION-2

One of the key principles of accrual basis of accounting requires that an asset's cost is proportionally expensed based on the period over which the asset is expected to be used.

ANSWER

Statement is correct.

- One of the key principles of accrual basis of accounting requires that an asset's cost is proportionally expensed based on the period over which the asset is expected to be used. Both depreciation and amortization are methods that are used to prorate the cost of a specific type of asset over its useful life.
- Depreciation represents systematic allocation of the depreciable value of an item of PPE over its useful life while amortization represents systematic allocation of the depreciable amount of an intangible asset over its useful life.

QUESTION-3

Dividends are recognized in the statement of profit and loss only when the amount of dividend can be measured reliably.

ANSWER

Statement is incorrect.

Dividends are recognised in the statement of profit and loss only when:

- the entity's right to receive payment of the dividend is established;
- it is probable that the economic benefits associated with the dividend will flow to the entity; and
- the amount of the dividend can be measured reliably.

QUESTION-4

If the purpose of an audit procedure is to test for understatement in the existence or valuation of accounts payable then testing the recorded accounts payable may be relevant audit procedure.

ANSWER

Statement is incorrect.

- If the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure.
- On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.

QUESTION-5

AS per 26, internally generated goodwill is not recognised as an asset.

ANSWER**Statement is correct.**

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

QUESTION-6

No entry is passed for Cheques received by the auditee on the last day of the year and not yet deposited with the Bank.

ANSWER**Statement is incorrect.**

The person who is controlling the trade receivables should ensure that proper accounting entries have been passed by crediting respective trade receivables account. The balance of cheque in hand should be disclosed along with the cash and bank balances in the financial statements.

QUESTION-7

It is the function of an audit to establish that payments have been made validly to the persons who are shown to be recipients.

ANSWER**Statement is correct.**

It is the function of audit to establish that payments have been made validly to persons who are shown to be recipients. For checking the validity of a transaction, it is usually necessary to refer to documentary evidence.

QUESTION-8

Computer software which is the integral part of the related hardware should be treated as fixed asset/tangible asset.

ANSWER**Statement is correct.**

As per AS-26 on Intangible Assets, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. Therefore, computer software which is the integral part of the related hardware should be treated as fixed asset/tangible asset.

QUESTION-9

Electronic payment of Income Tax cannot be made by an assessee from the account of any other person.

ANSWER**Statement is incorrect.**

- Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards. The assessee 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.
- It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank.

QUESTION-10

Negative assertions, encountered in the financial statements, may be expressed or implied.

ANSWER**Statement is correct.**

Negative assertions are also encountered in the financial statements and the same may be expressed or implied. For example, if it is stated that there is no contingent liability it would be an expressed negative assertion; on the other hand, if in the balance sheet there is no item as "building", it would be an implied negative assertion that the entity did not own any building on the balance sheet date.

QUESTION-11

A company should disclose in its Annual Report, the shares in the company held by each shareholder holding more than 10% shares specifying the number of shares held.

ANSWER**Statement is incorrect.**

As per requirements of Schedule III (Division I), shares in the company held by each shareholder holding more than 5% shares specifying the number of shares held need to be disclosed in the financial statements.

QUESTION-12

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.

ANSWER**Statement is incorrect.**

Assertions refer to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

QUESTION-13

Amortization represents systematic allocation of the depreciable amount of an item of Property, Plant and Equipment (PPE) over its useful life.

ANSWER**Statement is incorrect.**

Depreciation represents systematic allocation of the depreciable value of an item of PPE over its useful life while amortization represents systematic allocation of the depreciable amount of an intangible asset over its useful life.

QUESTION-14

Internally generated Goodwill can be recognized as an asset.

ANSWER**Statement is incorrect.**

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.

QUESTION-15

If Company X's balance sheet shows building with carrying amount of 100 lakh, the auditor shall assume that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.

ANSWER**Statement is incorrect.**

Showing building with carrying amount of 100 lakhs in the balance sheet entitled the auditor to assume that the management has represented 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 at 100 lakhs (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of * 100 lakhs (Completeness assertion).

QUESTION-16

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.

ANSWER

Statement is incorrect.

As per Section 52 of Companies Act, 2013, securities premium account can be utilized for below mentioned purposes:

- 1) Towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- 2) In writing off the preliminary expenses of the company;
- 3) In writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- 4) In providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- 5) For the purchase of its own shares or other securities u/s 68.

QUESTION-17

Material and wages are considered to be revenue expenditure when incurred for construction of building.

ANSWER

Statement is incorrect.

Material and Wages incurred on construction of building qualify to be capital expenditure as per AS 10 "Plant, Property and Equipment". Therefore, these have to be added to the cost of the asset i.e. building and shall not be expensed off to Statement of Profit and Loss.

QUESTION-18

PPE are depreciated when the asset is actually put to active use.

ANSWER

Statement is incorrect.

Depreciation is a fall in value of asset due to obsolescence, usage and effluxion of time, Therefore, depreciation is charged when the asset is ready for use. Active use of asset is not a mandatory criterion for charge of depreciation.

QUESTION-19

Increase in authorized capital of the company requires special resolution to be passed at the general meeting.

ANSWER

Statement is incorrect.

Increase in Authorised capital requires alteration of capital clause of Memorandum of Association. Therefore, ordinary resolution is passed for increase in Authorised capital of the company as per the Companies Act, 2013.

QUESTION-20

Capital redemption reserve can be used for distribution of dividends.

ANSWER

Statement is incorrect.

Capital Redemption reserve is not a free reserve. It is a restrictive reserve and can be used only for purposes given in the Act. Since it is not a free reserve, it cannot be utilized for payment of dividends. CRR can be used only for the purpose of issuing fully paid-up bonus shares.

QUESTION-21

Dividends are recommended by the Board, and declared by the Shareholders.

ANSWER

Statement is correct.

- The dividends are recommended by the Board of Directors by passing a resolution at the board meeting. The Shareholders declare the dividends at the AGM by passing an ordinary resolution. Declaration of dividend is an item of ordinary business.
- However, the shareholders can decrease the amount of dividends recommended by the board but cannot increase it.

QUESTION-22

In verifying Trade Receivables balance, Direct Confirmation Procedure is one of the important audit activity.

ANSWER

Statement is correct.

- While auditing trade receivable balance, direct confirmations as per SA 505, is considered to be the most important audit activity. Direct confirmation can be sought from the debtors directly confirming their balance due. The replies to the confirmation can be then matched with the records maintained by the client.
- Any discrepancies so revealed, can be investigated and checked in detail for possibility of any risk of material misstatement. Auditor selects few debtors' balances and ask the client to prepare the confirmations properly addressed to the debtors. Auditor maintains strict control over this process.

QUESTION-23

According to Sec. 53 of the Companies Act, 2013, a company can issue shares at a discount.

ANSWER

Statement is incorrect.

As per Sec. 53 of the Companies Act, 2013, 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.

QUESTION-24

An intangible asset is an identifiable monetary asset.

ANSWER

Statements is incorrect.

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

QUESTION-25

Depending on how the business operates, the management may value inventory using weighted average basis.

ANSWER

Statement is incorrect.

As per AS 2 "Valuation of Inventories" depending on how the business operates, the management may value inventory using First-in first-out (FIFO) or weighted average basis.

QUESTION-26

Mr. Z, a team member of auditor of Grateful and Competent Limited was of the opinion that while conducting an audit of a company no distinction is required to be made between revenue expenditure and capital expenditure.

ANSWER

Statement is incorrect.

Opinion of Mr. Z is not because one of the important aspects to be followed while conducting audit of a company is that a distinction is required to be made properly between revenue expenditure and capital expenditure.

QUESTION-27

Employee benefits expense represents the amount an entity pays to its employees for their labour/ efforts only.

ANSWER

Statement is incorrect.

Employee benefits expenses, commonly called payroll expenses, represent the aggregate sum an entity not pays to its employees for their labour/ efforts, as well as associated expenses such as perquisites/ benefits, postemployment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.

QUESTION-28

Dividends are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established.

ANSWER

Statement is incorrect.

Recognition of dividend in the statement of profit and loss is subject to satisfaction of following conditions:

- the entity's right to receive payment of the dividend is established;
- it is probable that the economic benefits associated with the dividend will flow to the entity; and
- the amount of the dividend can be measured reliably.

QUESTION-29

"Sweat Equity Shares" means equity shares issued by the company to employees or directors at a premium 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.

ANSWER

Statement is incorrect.

As per section 2(88) of Companies Act, 2013 "Sweat Equity Shares" means 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.

QUESTION-30

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

ANSWER

Statement is incorrect.

- Capital reserve represents surplus or profit earned in respect of certain types of transactions (like sale of fixed assets at a price in excess of cost, realization of profits on issue of forfeited shares, etc.) which are not regarded by the directors as free for distribution as a dividend.
- Profits that are available for distribution to shareholders held for the time being or any one or more purpose are generally classified as Revenue Reserve.

QUESTION-31

Capital reserve, generally, can be utilized for writing down fictitious assets or losses or (subject to shop provisions in the Articles) for issuing bonus shares if it is realized.

ANSWER**Statement is correct.**

- Capital reserve represents surplus or profit earned in respect of certain types of transactions (like sale of fixed assets at a price in excess of cost, realization of profits on issue of forfeited shares, etc.) which are not regarded by the directors as free for distribution as a dividend.
- Capital reserve, can be utilized for writing down fictitious assets or losses or for issuing bonus shares if it is realized. But the amount of share premium or capital redemption reserve account can be utilized only for the purpose specified in Sections 52 and 55 respectively of Companies Act, 2013.

CASE SCENARIO

Sunsteel Ltd. is a company engaged in the manufacture of variety of stainless steel household items ranging from hot pot, pressure cooker, cutlery set, bottles, to serving trays. The company has its corporate office in Delhi and its plant in Raigarh, a city in the state of Chhattisgarh. The company is planning to expand its manufacturing activities by setting up two new plants in the Raipur district of the state. For this purpose, the company also raised funds by making a follow-on public offer during the financial year 2022-23. R K Maheshwari & Associates are the statutory auditors of the company since the year 2020-21. The engagement team consisted of 5 members, with CA Raman as the engagement partner, CA Madhu as the senior associate and three articled trainees namely, Aman, Chetanya and Depesh.

The company raised fresh capital of 5 Cr during the FY 2022-23. The shares with the nominal value of 10 per share were issued at a premium of 5 per share.

The company has the Reserves and Surplus totaling to 2 Cr, comprising of securities premium and general reserve.

CA Raman directed CA Madhu to verify the issue of the share capital in detail giving special consideration to the utilization of the securities premium amount.

The audit engagement team discussed with the management about the performance of the company during the year under consideration. To this, the management told the engagement team that the company is performing very well and the company has doubled its revenue during the year as compared to the last year. The management of the company also told the auditors that during the year the company has made majority of its sales on credit basis to its customers.

CA Raman directed Mr. Aman to send balance confirmation requests to debtors having balance in excess of 1 lakh.

During the course of audit, CA Raman, Chetanya and Depesh also visited the power plants in Raigarh to get a detailed understanding of the manufacturing process.

The team performed analytical procedures to obtain audit evidence with respect to the overall reasonableness of purchase quantity and price of inventory. More specifically, Chetanya collected the reports from the management for composition of stock i.e. raw materials as a percentage of total stock and compared the same with the data of the previous year. CA Raman and Chetanya thereafter, discussed the reasons for the variations with the management.

Also, while considering the presentation and disclosure requirements as per Schedule III to the Companies Act, CA Madhu discussed with CA Raman the disclosure with respect to the following account balances:

- Current maturities to long term borrowings
- Long term maturities of finance lease obligations
- Interest accrued but not due on borrowings
- Interest accrued and due on borrowings

➤ Based on the above facts, answer the following questions:

Q.1 Which of the following is not correct with respect to shares issued at premium and securities premium account in terms of Section 52 of the Companies Act, 2013?

- a) 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.
- b) The securities premium account can be applied by the company in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares.
- c) The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.
- d) The securities premium account can be applied by the company for the purchase of its own shares or securities under section 68.

Q.2 Which of the following is not an example of capital reserve?

- a) Revaluation reserve arising from revaluation of fixed assets
- b) Securities Premium
- c) Capital redemption reserve
- d) General reserve

Q.3 Statement 1: Confirmations as well as undelivered letters should be given/ returned to the auditor and not to the client.

Statement 2: When no reply is received, the auditor should perform alternate procedures regarding the balances.

- a) Only statement 1 is correct
- b) Only statement 2 is correct
- c) Both statements 1 & 2 are correct
- d) Both statements 1 & 2 are incorrect

Q.4 Mr. Chetanya performed which of the following analytical procedures to obtain the audit evidence with respect to the overall reasonableness of purchase quantity and price of raw material?

- a) Consumption Analysis
- b) Stock Composition Analysis
- c) Reasonableness test
- d) Ratio analysis

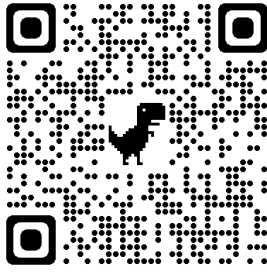
Q.5 Which of the following is not correct with respect to the disclosure requirements of Schedule III to the Companies Act 2013?

- a) Current maturities of long term borrowings is to be disclosed under the head long term borrowings
- b) Long term maturities of finance lease obligations is to be disclosed under the head long term borrowings
- c) Interest accrued but not due on borrowings is to be disclosed under the head Other Current Liabilities
- d) Interest accrued and due on borrowings is to be disclosed under the head Other Current Liabilities

Answer

- 1. (c)
- 2. (d)
- 3. (c)
- 4. (b)
- 5. (a)

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STUDY MATERIAL QUESTIONS

QUESTION-1

CA Sonali Morarka has completed audit of a listed company. The audit report dated 15th July, 2023 has been issued. However, audit working papers including record of discussions with management, details of audit procedures performed to obtain audit evidence and conclusions reached by her have not been properly assembled. More than six months have elapsed after issue of audit report.

Subsequently, she has received a letter from regulator in connection with audit of the company requesting her to share copy of audit file.

ANSWER

Assembly Of Final Audit File

- 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.
- Further, preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized.
- Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.
- In the given case, even after passage of more than six months, she has not assembled audit file. Besides, she has put in some papers with current date which is not permissible at all.
- **Conclusion:**
Facts as stated in this situation shows that part of audit documentation has been prepared afterwards, hence, putting a question mark on quality of audit.

QUESTION-2

During the course of audit of a company, an issue arose relating to treatment of interest costs of company on its restructured loans taken from a bank.

This important matter was discussed with CFO of the company and was properly resolved. Is it necessary for the auditor to include in its working papers?

ANSWER

Documentation Of Significant Matters

- Auditor shall document discussions of significant matters with management, TCWG and others, including the nature of the significant matters discussed and when and with whom the discussions took place.
- In the instant case, an important matter regarding treatment of interest costs of company on its restructured loans taken from a bank directly impacting profits of the company was discussed.
- **Conclusion:**
Although issue was resolved, it is necessary to document the same by including detail of the person with whom discussions took place along with date.

QUESTION-3

Define audit documentation. Also give some examples

ANSWER

Audit Documentation

SA 230 "Audit Documentation" defines the term as audit documentation as record of:

- audit procedures performed;
- relevant audit evidence obtained; and
- the conclusions the auditor reached.

Examples Of Audit Documentation Include

- a) Audit programmes.
- b) Analyses.
- c) Issues memoranda.
- d) Summaries of significant matters.
- e) Letters of confirmation and representation.
- f) Checklists.
- g) Correspondence (including e-mail) concerning significant matters.

QUESTION-4

A new team member of the auditors of Extremely Vibrant Limited was of the view that Audit Documentation does not help in planning the audit of any company.

Explain whether Audit Documentation has any relation with regard to planning the audit of a company.

ANSWER

Purposes Of Audit Documentation

Audit Documentation helps in planning the audit of a company in a proper manner and also helps in conducting the audit of that company in a more effective way.

QUESTION-5

While auditing the books of accounts of Very Careful Limited for the financial year 2023-24, a team member of the auditors of Very Careful Limited was of the view that with regard to audit of the company, no relation exists between Audit File and Audit Documentation.

Explain the relationship between Audit File and Audit Documentation.

ANSWER

Relationship Between Audit File And Audit Documentation

- Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.
- 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.

QUESTION-6

A director of Very Different Limited was of the view that Audit Documentation of a company is the property of that company.

Comment on the contention of the director regarding the audit documentation of the company.

ANSWER

Ownership Of Audit Documentation

Audit Documentation of a company is not the property of the company rather Audit Documentation is the property of Auditor of that company.

QUESTION-7

The form, content and extent of audit documentation depend on factors such as the size and complexity of the entity, the nature of the audit procedures to be performed etc.

Explain in detail.

ANSWER**Factors affecting Form, Content and Extent of Audit Documentation**

- SA 230 "Audit Documentation" deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements.
- ***Accordingly, the various factors that may affect form, content and extent of audit documentation are following:***
 - 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.

QUESTION-8

"Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits". Explain.

ANSWER**Completion Memorandum (Audit Documentation Summary)**

- SA 230 "Audit Documentation" defines the term as "Record of audit procedures performed, relevant audit evidence obtained and the conclusions the auditor reached".
- ***Accordingly, auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (known as a completion memorandum) that describes:***
 - a) the significant matters identified during the audit and
 - b) how they were addressed.
- Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits.
- Preparation of such a summary may assist the auditor's consideration of the significant matters.
- Further, the preparation of such a summary may assist the auditor's consideration of the significant matters.
- It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant SA objective that the auditor has not met or is unable to meet that would prevent the auditor from achieving the auditor's overall objective.

QUESTION-9

Discuss any two purposes of audit documentation.

ANSWER***The following are the purpose of Audit documentation:***

- a) Assisting the engagement team to plan and perform the audit.
- b) Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.

- c) Enabling the engagement team to be accountable for its work.
- d) Retaining a record of matters of continuing significance to future audits.
- e) Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

MCQS BASED QUESTIONS

(1) Which of the following statement is appropriately suited to preparation of audit documentation?

- (a) Audit documentation has to be prepared simultaneously as audit progresses.
- (b) Audit documentation has to be prepared 60 days after date of audit report.
- (c) Audit documentation has to be prepared when information is required by regulator.
- (d) Audit documentation has to be prepared 60 days after completion of audit work.

(2) Audit documentation is owned by: -

- (a) Client
- (b) Auditor
- (c) Team member responsible for documentation
- (d) Regulator

(3) Which of the following is least likely to be included in audit documentation of a company engaged in manufacturing and export of goods?

- (a) Previous years audited financial statements
- (b) Projected cash flow statement for next twelve months provided by management in support of going concern assumption
- (c) Statements showing dispatch of overseas consignments in accordance with delivery schedules of overseas buyers
- (d) Statement showing verification of ageing of trade receivables as on date of balance sheet

(4) Which of the following is false in relation to audit documentation when an external auditor relies upon work of internal auditor?

- (a) Evaluation of objectivity and competence of internal auditor has to be documented.
- (b) Nature of work used and reason for relying upon work used forms part of documentation.
- (c) Documentation on whether quality control is exercised in internal audit work forms part of audit documentation.

- (d) Documentation on what specific recommendations were given by internal auditor for risk assessment to external auditor forms part of audit documentation.

Answers to the MCQs based Questions

1. a 2. b 3. c 4. d

TRUE/FALSE QUESTIONS

QUESTION-1

The auditor must include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking etc.

ANSWER

Statement is incorrect.

The auditor need not include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of notes that documents corrected for typographical or other errors, and duplicates of documents.

QUESTION-2

Audit documentation is a substitute for the entity's accounting records.

ANSWER

Statement is incorrect.

- The auditor may include copies of the entity's records (for example, significant example, significant and specific contracts and agreements) as part of audit documentation.
- Audit documentation is not a substitute for the entity's accounting records.

QUESTION-3

The auditor shall prepare audit documentation on a timely basis.

ANSWER

Statement is correct.

- Auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized.
- Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

QUESTION-4

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 30 days after the date of the auditor's report.

Or

SQC1 requires engagement partner 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 30 days after the date of the auditor's report.

Or

The auditor shall assemble the audit documentation in the audit file and complete the administrative process of assembling the final audit file before the date of auditor's report.

ANSWER

Statement is incorrect.

- SQC 1, 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.

QUESTION-5

As per SA 230 on "Audit Documentation", the working papers are not the property of the auditor.

ANSWER

Statement is incorrect.

- As per SA 230 on "Audit Documentation" the working papers are the property of the auditor and the auditor has right to retain them.
- He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.

QUESTION-6

The Audit engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor's report or is later, the date of the group auditor's report, which ever.

ANSWER

Statement is incorrect.

As per requirements of SQC 1 and SA 230, audit engagement documentations should be kept for a minimum of 7 years from the date of audit report.

QUESTION-7

Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining of the branch audit

ANSWER

- Statement is incorrect. SA 230 issued by ICAI on Audit Documentation, and SQC 1 provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor.
- He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

CASE STUDY

CA Rajan Pillai is heading the engagement team conducting audit of a company. While audit is in progress, consider following issues regarding audit documentation:

- (A) Audit programme was prepared assigning responsibilities for different types of works to be performed to team members. The engagement team consists of 4 members Mohit (CA final student), Rohit (CA final student), Shobhit (Paid CA) and CA Rajan Pillai (Partner of audit firm).**
- (B) The team has determined materiality for financial statements as a whole.**
- (C) The team has assessed risks of material misstatements to be low.**

- (D) CA Shobhit is responsible for attending inventory count process and putting down its documentation part.
(E) During the course of audit, many related party transactions have come to notice.

➤ On the basis of above, answer the following questions:

Q.1 Work relating to verification of revenue was assigned to Mohit in audit programme. However, it is being performed by Rohit actually. Verification of trade receivables was planned to be carried out by Rohit in audit programme. However, it being performed by CA Rajan Pillai due to last minute practical issues. Which of the following statements is most appropriate in this regard relating to audit documentation?

- a) Audit programme contains names of persons and work to be performed. It is immaterial whether work assigned to one person is performed by another person.
- b) Audit programme was already prepared. Only persons assigned specific responsibilities can perform those duties.
- c) It is necessary that audit programme be suitably updated or notes are given in working papers to this effect so that planned duties are in accordance with actual work performance.
- d) Changes in audit programme or notes clarifying the matter are required only when a person not forming part of engagement team is deputed to perform a duty. Otherwise, this issue of inter-shuffling of team members is frivolous.

Q.2 As regards materiality, which of the following statements is most appropriate in context of audit documentation?

- a) Materiality has already been determined. There is no need to put it into working papers.
- b) Materiality depends upon professional judgment of auditor. Whatever amount has been determined can be documented in working papers.
- c) Materiality arrived on basis of professional judgment along with factors considered in the determination has to be documented.
- d) Materiality has been arrived upon professional judgment. It also depends upon professional judgment of auditor whether he wants to document it or not.

Q.3 As regards team's assessment that risk of material misstatements is low, which of the following statements is odd one relating to documentation of risk?

- a) Discussion amongst engagement team members and detail of significant decisions reached has to be documented.
- b) Details of risk assessment procedures have to be documented.
- c) Details about how understanding of each component of internal control was obtained has to be documented.
- d) Precise calculation of risk of material misstatements has to be documented.

Q.4 CA Shobhit is responsible for attending physical inventory count of the company. Which of the following is not true in this regard relating to audit documentation?

- a) Dates on which physical inventory count process was attended by him should be documented. It may also include photographs of that date showing his attendance of inventory counting process at a particular location.
- b) Detail of test counting undertaken should form part of audit documentation.
- c) Detail of obsolete goods found should form part of audit documentation.
- d) Reports showing that stocks conform to quality control standards in accordance with law are essential part of audit documentation.

Q.5 As regards related party transactions, which of the following should not be part of audit documentation?

- a) Management representation letter in this regard
- b) Related party transaction policy of the company

- c) Documentation to show that such transactions are at arm's length basis
- d) Documentation to show that such transactions are at close length basis.

ANSWERS

1 (c)


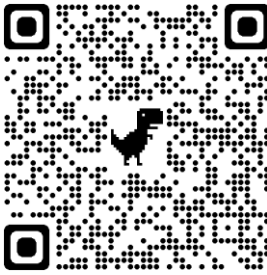


2 (c)

3 (d)

4 (d)

5 (d)

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STUDY MATERIAL QUESTION

QUESTION-1

Write short note on: Contents of written communication of significant deficiencies in internal control.

ANSWER

Contents Of Written Communication Of Significant Deficiencies In Internal Control:

- a) A description of the deficiencies and an explanation of their potential effects; and
- b) Sufficient information to enable TCWG and management to understand the context of the communication.

In particular, the auditor shall explain that:

- (i) The purpose of the audit was for the auditor to express an opinion on the F.S.;
- (ii) The audit included consideration of internal control relevant to the preparation of the F.S. in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and
- (iii) The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to TCWG.

QUESTION-2

On reviewing internal control over inventories as part of statutory audit of a company, auditor finds that physical verification is not being conducted at regular intervals as stipulated by the management. The auditor finds it to be significant deficiency in internal control over inventories. He points it out to the management in a one-liner as under:

"Physical verification of inventories is not being conducted at regular intervals as stipulated by management."

Is above communication by auditor proper? Ignore statutory reporting requirements, if any in this regard.

ANSWER

Communicating Deficiencies in Internal Control:

- While pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to TCWG and management to understand context of communication. Therefore, the above communication is not proper.
- Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not carrying out physical verification of inventories at regular intervals as stipulated by management. It should explain that such a significant deficiency can lead to misstatement of inventories impacting profits of the company.
- Highlighting importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

QUESTION-3

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".

ANSWER

Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency

- 1) The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- 2) The susceptibility to loss or fraud of the related asset or liability.

- 3) The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- 4) The financial statement amounts exposed to the deficiencies.
- 5) The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- 6) **The importance of the controls to the financial reporting process, for example:**
 - General monitoring controls (such as oversight of management)
 - Controls over the prevention and detection of fraud.
 - Controls over the selection and application of significant accounting policies.
 - Controls over significant transactions with related parties. ▪ Controls over significant transactions outside the entity's normal course of business.
 - Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- 7) The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.

QUESTION-4

Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd. You observed deficiency exist in the internal control system and you want to ascertain the same.

Elucide the various indicators of significant deficiencies which will help ypu in assessing the efficiency of thernal control system of the organisation .

ANSWER

Examples Of Indicators Of Significant Deficiencies In Internal Control

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

QUESTION-5

In what ways an effective two-way communication between auditor and those charged with governance is important?

ANSWER

Role of Communication:

Effective two-way communication is important in assisting:

- a) Auditor and TCWG in understanding matters related to the audit and in developing a constructive working relationship;

- b) Auditor in obtaining from TCWG information relevant to the audit. For example, TCWG may assist auditor in understanding entity and its environment, in identifying appropriate sources of bish audit evidence, and in providing information about specific transactions or events; and
- c) TCWG in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the RoMM.

QUESTION-6

Discuss with reference to SAS: The auditor shall communicate all significant findings with those charged with Governance.

Or

"The auditors should communicate audit matters of governance interest arising from the audit of financial statements with those charged with the governance of an entity". Briefly state the matters to be included in such Communication.

ANSWER

Communicating Significant Finding to TCWG:

SA 260 "Communication with Those charged with Governance" deals with auditor's responsibilities to communicate with TCWG in an audit of financial statements.

As per SA 260, auditor should communicate all significant findings with the TCWG, stated as below:

- (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
- (b) Significant difficulties, if any, encountered during the audit;
- (c) Unless all of those charged with governance are involved in managing the entity:
- Significant matters, arising from the audit that were discussed, or subject to correspondence with management; and
 - Written representations the auditor is requesting;
- (d) Circumstances that affect the form and content of the auditor's report, if any; and
- (e) Any other significant matter that in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

QUESTION-7

CA PK Jacob is conducting audit of a company for year 2022-23. The company is engaged in export of ethnic rugs to buyers in Europe. The audit is nearing completion in month of July 2023.

However, it becomes known to the auditor that one of overseas buyers has made a legal claim against the company on 1st June 2023 for injury caused to a customer of one European buyer due to sub- standard dyes used in rugs of one lot of order shipped in August, 2022.

The management of company has decided to agree to an out of court settlement of ₹ 5 crore to protect its reputation. The financial statements of the company are silent on this issue.

Discuss, how, CA PK Jacob should proceed to deal with above issue.

ANSWER

Subsequent Events:

- In the given case, the auditor has come to know of legal claim against the company before issue of audit report. It has also come to his knowledge that management of company has agreed to an out of court settlement of 5 crore.
- It is an example of subsequent event between the date of the financial statements and the date of the auditor's report. It provides evidence of conditions that existed at the date of the financial statements and requires adjustment in financial statements.
- He should ask company management to make necessary adjustment to the financial statements.
- If adjustment is not made by management, auditor should consider impact on auditor's report.

QUESTION-8

CA Chandni Khanna is going to complete audit of a company within next few days. She has performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings held after date of financial statements, going through books of accounts after date of financial statements to make sure that all subsequent events before signing audit report have been Sedim considered by her. Still, she wants to be certain that no such events have been left out. What she should do in such a situation? Also, discuss the rationale of doing so.

ANSWER**Rationale Of Performing Audit Procedures For Subsequent Events**

- Auditor has already performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings after date of financial statements and going through books after date of financial statements.
- Now, she should request management and, where appropriate, TCWG, to provide a written representation in accordance with SA 580, "Written Representations" that all events occurring subsequent to the date of the financial statements and for which the applicable FRF requires adjustment or disclosure have been adjusted or disclosed.
- Rationale of obtaining written representations is that even after performing above said procedures, she may not come to know all subsequent events. Therefore, it is necessary from an auditor's point of view to obtain acknowledgment from management in the form of Written representations that all such events for which the applicable FRF requires adjustment or disclosure have been adjusted or disclosed.

QUESTION-9

Discuss meaning of "Date the financial statements are issued" under SA 560.

ANSWER**Meaning Of "Date The Financial Statements Are Issued**

- 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

QUESTION-10

During course of audit of a company, CA. Varun Aggarwal notices that company is facing significant skilled labour shortages resulting in hampering of operations of company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP.

However, due to job opportunities available near villages now, many are not interested in going out from their native villages.

Such a situation has led to company not being able to keep its commitments, losing out on orders and fall in its revenues. Fixed costs of the company remain at a high level. As a result, company is facing a liquidity crunch and is not able to pay its creditors on time.

The bankers of company are also not willing to help the company to tide over liquidity crisis. The auditor is having doubts over going concern status of the company.

How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditor in such a situation?

ANSWER**Audit Procedures in case of Doubt overgoing Concern Status**

- Significant shortage of skilled labour, inability to pay creditors on time and overall liquidity crisis faced by the company are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.
- In such a situation, management should try to address auditor's concerns by preparing its future plan of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address auditor's concerns regarding liquidity crisis being faced by the company.
- Auditor should perform audit procedures to evaluate the reliability of the underlying data to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast.
- Auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.

QUESTION-11

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?

ANSWER

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 SAAE regarding management's use of the going concern basis of accounting in the preparation of the F.S.

QUESTION-12

You are nearing completion of audit of a company. On going through your working papers, it is noticed that finished goods inventory was overvalued by ₹ 2 crore. It has also been noticed that freight of 10 lacs paid on import of machinery was charged to statement of profit and loss.

Discuss, how you should, proceed and communicate in above situation before signing audit report.

ANSWER

Evaluation Of Misstatements Identified During The Audit

- Instances highlighted in given situation are examples of misstatements identified during the audit. Over valuation of inventory of finished goods by 2 crore and wrongly charging freight of 10 lacs paid on machinery to statement of profit and loss instead of capitalizing are examples of misstatements.
- Auditor should communicate above identified misstatements to TCWG and request for correction of these misstatements. In case, these are not corrected, understand the reasons for not making the corrections and reassess materiality.
- It should also be considered whether uncorrected statements are material individually or in aggregate. Effect of uncorrected misstatements on the opinion in auditor's report should be communicated to TCWG.

QUESTION-13

Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450.

ANSWER

Documentation Requirements Regarding Misstatements Identified During Audit

Documentation shall include:

- (1) Amount below which misstatements would be regarded as clearly trivial;
- (2) All misstatements accumulated during the audit and whether they have been corrected; &
- (3) Auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion

QUESTION-14

CA R Gurumurthy is about to complete audit of a company. Before completion, he asks management to provide him a written representation confirming that management has fulfilled its responsibilities regarding preparation of financial statements. He also wants management to confirm in writing about providing of all the necessary information and completeness of transactions to him.

The management feels that auditor is seeking irrelevant documents near the completion of audit. Why view of management is not proper?

What possible implications it may lead to?

ANSWER

Requirement Of Management Representations

- View of management is not proper. Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities.
- This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.
- In case of refusal of management to provide such a confirmation, it may lead to disclaimer of opinion by the auditor.

MCQS BASED QUESTIONS

(1) An auditor of a company communicates significant findings from audit with those charged with governance in the company. Which of the statements is false in regard to communication made?

- (a) Evaluation of adequacy of communication process is required on part of the auditor.
- (b) Planned scope and timing of audit has also to be communicated.
- (c) Communication of rationale behind audit procedures is necessary.
- (d) Significant difficulties encountered during audit, if any, have to be communicated.

(2) Written representations are: -

- (a) Necessary audit evidence
- (b) Sufficient appropriate audit evidence
- (c) Not audit evidence
- (d) Audit evidence depending upon auditor's professional judgment

(3) Which of the following is false regarding communication of misstatements identified during course of an audit?

- (a) The auditor should request those charged with governance for correction

of identified misstatements.

- (b) The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is material.
- (a) The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is immaterial.
- (b) The auditor should communicate effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

(4) Which of the following is not an example of subsequent event?

- (a) Event occurring between date of financial statements and date of auditor's report.
- (b) Event occurring on date of financial statements.
- (c) Event occurring after filing audit report with tax authorities. Had such an event been known earlier, auditor would have amended report.
- (d) Event occurring during course of performing audit procedures after date of financial statements.

(5) Which of the following is not an example of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern?

- (a) Adverse key financial ratios
- (b) Inability to invest in modernisation of plant
- (c) Inability to pay creditors on time
- (d) Inability to pay salary of staff

Answers to the MCQs based Questions

1. (c) 2. (a) 3. (b) 4. (b) 5. (b)

TRUE/FALSE QUESTIONS

QUESTION-1

One of the objectives of the written representation is to support other audit evidence relevant to the financial statements.

ANSWER

Statement is correct.

- One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation.
- Written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

QUESTION-2

Written representation in itself is a sufficient and appropriate audit evidence about any of the matters with which they deal.

ANSWER

Statement is incorrect.

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.

QUESTION-3

Written representation from management can be a substitute for other evidence that the auditor could expect to be reasonably available.

ANSWER

Statement is incorrect.

- One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation.
- So, it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available

QUESTION-4

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

ANSWER

Statement is correct.

- 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.

CASE SCENARIO

CA. Gaurav Gogoi is about to conclude audit of a company. It has been noticed during the course of audit that there is shortage of important raw material supplies being imported from China due to prevailing geo- political situation. The company has shared with him its plan to deal with the situation. He is satisfied with assessment of the company for dealing with the matter. The issue is disclosed in financial statements and considering management's assessment, it is felt that use of going concern assumption by company in preparation of financial statements is appropriate.

Besides, he also wants to be sure that all subsequent events till now have been considered and accounted for, where ever necessary, in financial statements.

Before concluding audit, he requests written representations from management regarding its responsibilities. However, it is noticed that such written representations provided by management use qualifying language.

He has also communicated significant findings from audit in writing with those charged with governance in the company and has retained copy of relevant mails.

Besides, there are certain matters which were communicated by him orally from time to time during the course of audit to those charged with governance.

➤ **Based on above, answer the following questions: -**

Q.1 As regards description of matter above concerning issue of going concern, which of the following grim statements is most appropriate for auditor's report?

- a) The auditor should express an unmodified opinion.
- b) The auditor should express a qualified opinion as material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

- c) Besides expressing an unmodified opinion, the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" drawing attention to the note in which such disclosure is made in financial statements along with related matters.
- d) Such an issue does not affect auditor's opinion.

Q.2. As regards going concern basis of accounting is concerned, which of the following statements is true?

- a) A company showing net loss in its financial statements is essentially not a going concern.
- b) Following going concern assumption of accounting is primary duty of auditor.
- c) In case, a company is not a going concern, its financial statements must be prepared on liquidation basis.
- d) Audit procedure seeking confirmation from banker regarding outstanding balance relates to verification of going concern assumption.

Q.3. Which of the following statements is true in respect of auditor's responsibilities in respect of subsequent events?

- a) There is no obligation for an auditor to perform audit procedures for events occurring between date of financial statements and date of auditor's report.
- b) There is no obligation for an auditor to perform audit procedures after signing of auditor's report, even if he comes to know of an event, which if known to him earlier would have caused him to amend the audit report.
- c) The auditor has only to rely upon written representation of management regarding subsequent events. He has no other means to know about such events.
- d) The auditor should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.

Q.4. As regards use of qualifying language in written representations, which of the following statement is most appropriate?

- a) It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.
- b) Written representations should be unconditional. Such a wording is not acceptable.
- c) Such a wording dilutes intent of written representations. However, it can be accepted by auditor only in exceptional circumstances.
- d) Qualifying language in written representations is compulsory.

5. As regards auditor's responsibility regarding matters communicated orally with those charged with governance, which of following is most appropriate?

- a) Matters communicated orally have to be documented by the auditor stating when and to whom these were communicated.
- b) Matters communicated orally need not be put into writing. It is sufficient for auditor to have communicated orally.
- c) Matters communicated orally need not be put into writing. It is not practically feasible.
- d) Matters communicated orally have to be documented by the auditor stating to whom these were communicated.

Answer

1 (c)


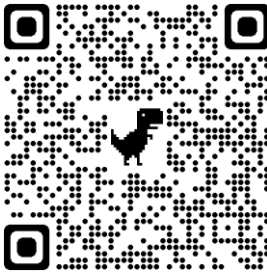


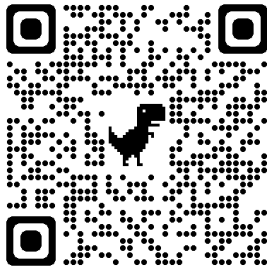

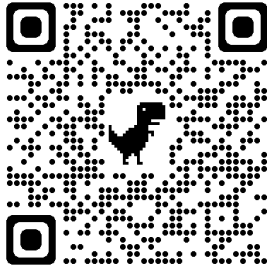
2 (c)

3 (d)

4 (a)

5 (a)

CA NOTES COMMUNITY NETWORK

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STUDY MATERIAL QUESTIONS

QUESTION-1

CA. Dicky Yadav is auditor of a company having four branches. The four branches are audited by another auditor CA. Yamini Jain. The reports in respect of accounts of branches examined by her have already been sent to company auditor.

During the course of audit, CA Dicky Yadav asks the branch auditor to share with her summary of audit procedures and findings in respect of accounts of branches examined. CA. Yamini Jain feels it as encroachment of her domain. Discuss the issue.

ANSWER

Rights of Principal Auditor:

- As per SA 600 - "Using the Work of Another Auditor", the principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.
- Such review of audit procedures and findings can be undertaken if principal auditor feels that it is necessary to apply such procedures to obtain sufficient appropriate audit evidence. It is not an encroachment of another auditor's domain.

QUESTION-2

A joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report.

Justify this statement in the light of responsibilities of Joint Auditors under SA 299.

ANSWER

Reporting Responsibilities Of Joint Auditor

- The statement that a joint auditor is not bound by the views of the majority of the joint auditors regarding the matters to be covered in the report is true.
- SA 299 "Joint Audit of Financial Statements" provides the following in respect of reporting responsibilities of joint auditor:**
 - Joint auditors are required to issue common audit report.
 - However, in case of any disagreement among joint auditors with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.
 - A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement.
 - In case of separate reports, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s). Such reference shall be made under the heading "Other Matter Paragraph" as per SA 706.

QUESTION-3

The company has dispensed with the practice of taking inventory of their inventories at the year- end as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations.

Explain reporting requirement under CARO, 2020.

ANSWER

Reporting Requirements Under CARO, 2020 As To Physical Verification Of Inventory

• **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;
- In the given case, the above requirement of physical verification of inventory by the management has not been taken place and therefore the auditor should point out the same under CARO, 2020. He may consider the impact on financial statement and report accordingly.

QUESTION-4

CA. Ravi Patnaik is conducting audit of a company for which reporting requirements under CARO, 2020 are applicable. He finds that cash credit facilities amounting to ₹ 4 crores were released to the company by branch of a bank for meeting its working capital requirements.

He finds that out of above funds, 1 crore have been used by company for installing effluent treatment plant to meet State pollution control Board requirements.

Is there any reporting obligation upon him under CARO, 2020?

ANSWER

Reporting Obligation Under CARO, 2020

- Clause (ix) (d) of CARO, 2020 requires the auditor to report whether funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated.
- In the given situation, funds have been raised for meeting working capital requirements for ₹ 4 crores. Cash credit facilities for meeting working capital requirements are, by their very nature, short term borrowings. Out of above, 1 crore have been used by the company for investment in effluent treatment plant which is ostensibly for a long-term purpose.
- **Conclusion:** Matter needs to be reported in accordance with requirements of Clause (ix) (d) of CARO, 2020.

QUESTION-5

Auditor's Report on Financial Statements of a Listed Entity Prepared in Accordance with a Fair Presentation Framework

ANSWER

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed company (registered under the Companies Act, 2013) using a fair presentation framework. The audit is not a group audit (i.e., SA 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with the accounting Standards prescribed under section 133 of the Companies Act, 2013.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise the Code of Ethics issued by ICAI together with the other relevant ethical requirements relating to the audit and the auditor refers to both.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- Key audit matters have been communicated in accordance with SA 701.

- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.

QUESTION-6

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.

ANSWER

Indicators Of Lack Of Neutrality

- 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:***
 - 1) 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.
 - 2) Possible management bias in the making of accounting estimates.

QUESTION-7

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.

ANSWER

Branch Auditor

- Sec. 143(8) 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.
- ***Accordingly, where a company has a branch office, the accounts of that office shall be audited by either of following:***
 - a) the auditor appointed for the company, i.e. company auditor, or
 - b) any other person qualified for appointment as an auditor of the company under this Act, or
 - c) 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.
- 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

QUESTION-8

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.

ANSWER**Points To Be Considered In Developing The Joint Audit Plan**

As per SA 299 "Joint Audit of Financial Statements" Prior to the commencement of the audit, the joint auditors shall 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.

QUESTION-9

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.

ANSWER**Advantages of 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.
- **Other advantages of joint audit are:**
 - a) Sharing of expertise.
 - b) Advantage of mutual consultation.
 - c) Lower workload.
 - d) Better quality of performance.
 - e) Improved service to the client.
 - f) In respect of MNCs, 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.
 - g) Lower staff development costs.
 - h) Lower costs to carry out the work.
 - i) A sense of healthy competition towards a better performance.

QUESTION-10

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

ANSWER**Companies Are Specifically Exempt From The Applicability Of CARO 2020**

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;
- (ii) an insurance company;
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company and a small company; 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 1 crore as on the balance sheet date and
 - which does not have total borrowings exceeding 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 (including revenue from discontinuing operations) exceeding 10 crore during the financial year as per the financial statements.

QUESTION-11

"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.

ANSWER

Forming An Opinion

- Auditor shall form an opinion on whether the F.S. are prepared in all material respects in accordance with the applicable FRF.
- To form this opinion, auditor needs to conclude as to whether he has obtained reasonable assurance that F.S. as a whole are free of material misstatements, whether due to fraud or error.
- ***The conclusion shall take into account:***
 - a) The auditor's conclusion, in accordance with SA 330, whether sufficient appropriate audit evidence has been obtained;
 - b) The auditor's conclusion, in accordance with SA 450, whether uncorrected misstatements are material, individually or in aggregate; and
 - c) The evaluations.

SA 700 - Forming an Opinion & Reporting on F.S.

QUESTION-1

M/s Smart & Associates are the statutory auditors of Hotmeals Ltd. for the FY 2023-24. How will the auditor address the audit report issued on the financial statements for the FY 2023-24?

Also give a title to the report.

ANSWER

Title And Addressee In Audit Report

Title: Independent Auditor's Report

Addressee: To the Members of Hot meals Ltd.

QUESTION-2

Richa International is a partnership firm dealing in export of blankets. The partners of the firm are Richa and Ashish.

Explain how the statutory auditor of the firm will address the auditor's report.

ANSWER

Addressee In Audit Report In Case Of Partnership Firm

Independent Auditor's Report

To the Partners of Richa International

QUESTION-3

Diamond Shine Ltd. is a company engaged in the manufacture of detergent. M/s Bright & Associates are the statutory auditors of the company.

Explain how the paragraph related to the management's responsibility will come in the auditor's report.

ANSWER

Management's Responsibility For The Standalone Financial Statements

- The Company's Board of Directors is responsible for the matters stated in Sec. 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these standalone financial statements that give a true and fair view of the financial position, financial performance, (changes in equity) and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the accounting Standards specified under section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgements and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statement that give a true and fair view and are free from material misstatement, whether due to fraud or error.
- In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. Those Board of Directors are also responsible for overseeing the Company's financial reporting process.

QUESTION-4

M/s Ajay Vijay & Associates are the statutory auditors of Sarovar Ltd. for the FY 2023-24. The company is engaged in the business of manufacture of water bottles. At the time of finalising the auditor's report, one of the audit team members asked CA Ajay, the engagement partner to advise as to how the auditor's responsibilities can be shown in an appendix to the auditor's report.

Draft the auditor's responsibility paragraph so as to advise the audit team member.

ANSWER

Auditor's Responsibilities For The Audit Of The Financial Statements

- Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.
- Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAS will always detect a material misstatement when it exists.
- Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
- A further description of our responsibilities for the audit of the financial statements is included in appendix X of this auditor's report. This description, which is located at [indicate page number or other specific reference to the location of the description forms part of our auditor's report.

QUESTION-5

M/s Amitabh & Associates are the statutory auditors of Ringston Ltd. which is a company engaged in the business of manufacture of pen drives.

The auditor has started drafting the audit report for the FY 2023-24. CA Amitabh, engagement partner is of the view that financial statements of Ringston Ltd. represent a true and fair view. Give draft of the opinion paragraph of the audit report.

ANSWER**Draft Of Opinion Paragraph**

- We have audited the financial statements of Ringston Limited which comprise the Balance Sheet as at 31.03.2024 and the statement of Profit and Loss Account and the notes to the financial statements, including a summary of significant accounting policies and other explanatory information.
- In our opinion and to the best of our information and according to the explanations given to us, the aforesaid financial statements give the information required by the Act in the manner so required and 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 31.03.2024 and Profit & Loss for the year ending on that date.

QUESTION-6

M/s Kite Rite & Associates are statutory auditors of Prime Deluxe Limited, for FY 2023-24. At the time of finalizing audit report, one of engagement team members, Mr. Robin, asked the engagement partner, CA Kite as to what all should be included in Basis of Opinion Paragraph.

The engagement partner CA Kite, explained the team in detail and asked Mr. Robin to draft such section for the auditor's report of Prime Deluxe Limited. Help Mr. Robin to draft the Basis for opinion section

ANSWER**Draft Of Basis For Opinion Section**

- We conducted our audit in accordance with the Standards on Auditing specified u/s 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.
- We are independent of the Company in accordance with the Code of Ethics issued by the ICAI together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

QUESTION-7

Maithili Thakur, a CA student, was perusing audit report of a company. Her eyes fell on an 18-digit alpha numeric number stated at end of audit report below the signatures of auditor and membership number.

Make her understand objective and significance of such a randomly generated number. Is it required to be stated in case of audit reports only?

ANSWER**UDIN**

- The 18-digit alpha numeric number noticed by her at end of audit report is Unique Document Identification number (UDIN). It is a system generated unique number. Its basic objective is to curb the malpractices of non-CAs impersonating themselves as CAS. It helps in securing reports and documents issued by practicing CAS.
- It is required to be stated in case of audit reports and certificates.

QUESTION-8

"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.

ANSWER

Qualitative Aspects Of The Entity's Accounting Practices

- a) Management makes a number of judgements about the amounts and disclosures in the F.S.
- b) SA 260 contains a discussion of qualitative aspects of accounting practices.
- c) In considering qualitative aspects of the entity's accounting practices, auditor may become aware of possible bias in management's judgements. Auditor may conclude that cumulative effect of lack of neutrality, together with effect of uncorrected misstatements, causes the F.S. as a whole to be materially misstated.
- d) SA 540 addresses possible management bias in making accounting estimates. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on reasonable-ness of individual accounting estimates.

QUESTION-9

M/S TUV & Associates are the statutory auditors of Venus Ltd. for the FY 2023-24. At the time of finalising the auditor's report, one of the audit team members asked the engagement partner, CA Tarun, to explain as to how the auditor's report will be signed.

Help CA Tarun in explaining the same.

ANSWER

Manner Of Signing The Audit Report

The following is the correct way of signing an audit report.

M/S TUV & Associates
Chartered Accountants
(Firm's Registration No.)
Signature
(Name of the Member Signing the Audit Report)
(Designation)
(Membership No. XXXXX)
UDIN: 20037320AAAAAH1111

Place of Signature:

Date:

QUESTION-10

CA. Maya Memani has conducted audit of a company. She has asked Sana, a CA student undergoing training in her office, to prepare draft audit report. Sana was part of engagement team conducting the audit. She has been further told to prepare draft report expressing unmodified opinion.

After drafting para comprising unmodified opinion, Sana feels no need to provide basis for opinion. Discuss why her thinking is not proper.

ANSWER

Need For Basis Of Opinion Section

"Basis for Opinion" is one of basic elements of an audit report in accordance with SA-700. Even in cases where unmodified opinion is expressed by auditor, "Basis for opinion" has to be provided by auditor. Basis for opinion section provides context about auditor's opinion.

Conclusion: -Sana's thinking is not proper.

QUESTION-11

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.

ANSWER

Opinion Section in the Auditor's Report:

As per SA 700 "Forming an Opinion and Reporting on Financial Statements", Opinion Section of the Auditor's Report shall include **the auditor's opinion, and shall have the heading "Opinion" and also cover the following:**

- a) Identify the entity whose FS have been audited;
- b) State that Financial Statements have been audited;
- c) Identify title of each statement that comprises F.S;
- d) Refer to the notes, including the summary of significant accounting policies; and
- e) Specify date of period covered by each Financial Statement.

QUESTION-12

"An auditor is required to make specific evaluations while forming an opinion in an audit report." State them.

ANSWER

Specific Evaluations By The Auditor:

The auditor shall evaluate whether:

- 1) The financial statements adequately disclose the significant accounting policies selected and applied;
- 2) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- 3) The accounting estimates made by management are reasonable;
- 4) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- 5) 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 not financial statements; and
- 6) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

QUESTION-13

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.

ANSWER

Responsibilities Of Management For The Financial Statements

- As per SA 700 "Forming an Opinion & Reporting on 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, TCWG, on which an audit in accordance with SAS is conducted. Management and, where appropriate, TCWG 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.

"Responsibilities of Management for the Financial Statements" section of auditor's report shall describe management's responsibility for:

- 1) Preparing the F.S. in accordance with the applicable FRF, and for such internal control as management determines is necessary to enable the preparation of F.S. that are free from material misstatement, whether due to fraud or error; and
- 2) 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.

QUESTION-14

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.

ANSWER

Scope Of SA 701

- 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:***
 - a) A substitute for disclosures in the F.S. that the applicable FRF requires management to make, or that are otherwise necessary to achieve fair presentation;
 - b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705;
 - c) 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
 - d) A separate opinion on individual matters.

QUESTION-15

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.

ANSWER

Basis For Opinion Section In The Auditor's Report:

As per SA 700 "Forming an Opinion and Reporting on Financial Statements", 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 SA;
- (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. The statement shall refer to the Code of Ethics issued by ICAI; and
- (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.

SA 705 - Modifications to the Opinion in the Independent Auditor's Report

QUESTION-1

Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2023-24 the company transferred its accounts to computerised system (SAP) from manual system of accounts. Since the employees of the company were not well versed with the SAP system, there were many errors in the accounting during the transition period.

As such the statutory auditors of the company were not able to extract correct data and reports from the system. Such data was not available manually also. Further, the employees and the management of the company were not supportive in providing the requisite information to the audit team.

Explain the kind of audit report that the statutory auditor of the company should issue in this case.

Answer

Issue of Disclaimer of Opinion

- When the statutory auditor of the company is unable to obtain sufficient and appropriate audit evidence, the auditor should give disclaimer of opinion as per SA 705.
- In the present case, the statutory auditor of the company is unable to extract correct data and reports from the SAP system for conduct of audit. Also, such data and reports are not available manually. As such, the statutory auditor of Delightful Ltd. should give a disclaimer of opinion.

QUESTION-2

M/s Daisy & Associates are the statutory auditors of Zebra Ltd. for the FY 2023-24. CA Daisy, the engagement partner wants to verify the cash in hand as on 31.03.2024. The cash balance of the company as on 31.03.2024 is 1,00,000 and the turnover of the company for the year is ₹ 6 crores.

The management of the company informs CA Daisy that such cash verification is not possible as the cashier is on leave for his marriage and no other employee of the company is available as all are busy in year ending activities.

Explain the relevant provisions to deal with such a situation.

Answer

Limitations Imposed After Accepting The Audit

- 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 is 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.
- In the present case CA Daisy, the statutory auditor is unable to verify the cash in hand of Zebra Ltd. as on 31.03.2024. The same is due to a limitation imposed by the management of Zebra Ltd. which is due to the non-availability of the cashier.
- In such situation, CA Daisy should perform alternate procedures to verify the cash on hand of the company. Further, CA Daisy should consider the impact on the auditor's report and may consider issuing a qualified opinion in this case.

QUESTION-3

CA. Sarasbhai Patel, while conducting audit of an entity, feels that there is an atmosphere of non-cooperation all around. He has not been provided with necessary support for attending inventory count process of entity as at year end. Besides, CFO is not providing him present addresses of customers as well as suppliers for sending external confirmations. Even mail ids have not been provided on the pretext of business confidentiality.

He was not able to verify revenues of entity due to lack of complete details. For verifying expenses, She has been asking for bills on a sample basis, but staff has been making lame excuses.

The matter but was brought to knowledge of higher echelons of management, but of no avail. The auditor feels that there could be misstatements and their possible effects would be material and affecting many aspects of financial statements.

Assuming it is not possible to withdraw from engagement, what type of opinion should be expressed by auditor?

Answer

Issue Of Disclaimer Of Opinion

- In the given case, auditor has not been able to obtain sufficient appropriate audit evidence relating to inventories, debtors, creditors, revenues and expenses. The matter has brought to knowledge of management but no result has been achieved. Besides, auditor opines that there could be misstatements and their possible effects could be both material and pervasive.
- In such circumstances, he should make disclaimer of opinion in accordance with SA 705.

QUESTION-4

M/s Sun Moon & Associates are the statutory auditors of Venus Ltd. for the FY 2023-24. Owing to the pervasive nature of material misstatements in the financial statements of the company, CA Moon, the engagement partner decided to give an adverse opinion.

Explain the responsibility of CA Moon with respect to communication with those charged with governance.

Answer

Communication With TCWG

CA Moon, being the statutory auditor of Venus Ltd. should communicate with those charged with governance about the circumstances that led to the expected modification i.e. an adverse opinion. Further the wording of such modification also needs to be discussed.

QUESTION-5

Super Duper Ltd. is a company engaged in the manufacture of office furniture. M/s Young Old & Associates are the statutory auditors of the company for the FY 2023-24.

During the year under audit, the engagement partner CA Young noticed that the company has not bifurcated its loans into long term and short term. CA Young understands that such misstatement is not pervasive though the same is material.

Explain the type of opinion that should be given by M/s Young Old & Associates in this case.

Answer

Type Of Opinion

M/s Young Old & Associates should give a qualified opinion as the effect of the misstatement on account of the non-bifurcation of loans into long term and short term loans, is material but not pervasive.

QUESTION-6

M/s Taj Raj & Associates are the statutory auditors of Porex Ltd. engaged in the manufacture of premium watches, for the FY 2023-24. During the course of the audit, CA Taj, the engagement partner found that the stocks and debtors of the company constituting about 80% of the total assets of the company are not realizable. Further, the cashier of the company has committed a fraud during the year under audit.

Both the facts are not reflected in the financial statements for the year ending 31.03.2024. Accordingly, CA Taj is of the view that the impact of both the situations on the financial statements is material and pervasive and thus, the financial statements represent a distorted view of the state of affairs of the company.

Explain the reporting requirements of CA Taj.

ANSWER

Reporting Requirements

- Auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- In case of Porex Ltd., CA Taj found that the stocks and debtors of the company constituting about 80% of the total assets of the company are not realizable. Further, the cashier of the company has committed a fraud during the year under audit. Such situations are not reflected in the financial statements of the company despite having a material and pervasive impact on the financial statements. As such, CA Taj should give an adverse opinion.
- Further, CA Taj should also consider the reporting responsibilities under CARO 2020 and Sec. 143 (12) of the Companies Act, 2013.

QUESTION-7

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

ANSWER

Adverse Opinion And A Qualified Opinion

- 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.
- SA 705 - "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 and its subsidiaries, associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2024, 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, 2024, 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, which comprise the balance sheet as at March 31, 2024, 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 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, 2024 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

QUESTION-8

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

ANSWER

Objective of the auditor as per SA 705:

To express clearly an appropriately modified opinion on the F.S. that is necessary when:

- (a) Auditor concludes, based on the audit evidence obtained, that the F.S. as a whole are not free from material misstatement;
or
(b) Auditor is unable to obtain SAAE to conclude that the F.S. as a whole are free from material misstatement.

QUESTION-9

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

ANSWER

Factors Affecting The Decision Regarding Type Of Modified Opinion:

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.

SA 706 - Emphasis of Matter Paragraphs & Other Matter Paragraphs in Independent Auditor's Report

QUESTION-1

Lomaxe Ltd. is a company engaged in the business of manufacture of candles. CA Kamalnath is the statutory auditor of the company for the FY 2023-24. During the year under audit, there was a fire in the company's factory as a result of which, some of the company's plant and machinery was destroyed.

The same was disclosed by the company in the notes to accounts annexed to the financial statements for the year ending 31.03.2024. CA Kamalnath decided to communicate this matter in the auditor's report as he is of the view that the matter is of such importance that it is fundamental to the user's understanding of the financial statements.

Help CA Kamalnath to deal with this situation in the auditor's report.

ANSWER

Inclusion of Emphasis of Matter Paragraph

In the present case 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 - Effects of Fire in Company's Factory**

We draw attention to Note Y of the financial statements, which describes the effects of a fire in the Company's factory. Our opinion is not modified in respect of this matter.

QUESTION-2

Define emphasis of matter paragraph and how it should be disclosed in the independent auditor's report.

ANSWER

Emphasis of Matter Paragraph:

- SA 706 "Emphasis of matter Paragraph and Other Paragraphs in the Independent Auditor's Report" defines Emphasis of Matter paragraph as Para included in Auditor's Report that refers to a matter appropriately presented/disclosed in financial statement that in the auditor's judgment is of such importance that it is fundamental to users' understanding of financial statements.
- EOM paragraph is not a substitute for need for expression of qualified opinion, adverse opinion or Disclaimer of opinion or the disclosures to be made by management in Financial statements as required by applicable FRF.

Circumstances when EOM Para can be included in Auditor's Report:

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

Disclosure Of Emphasis Of Matter Paragraph In The Auditor's Report:

As per SA 706, when the auditor includes an EOM paragraph in the auditor's report, the auditor shall:

- Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- 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
- Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

MCQS BASED QUESTIONS

1. **While expressing an unmodified opinion on financial statements, the auditor shall not use which of the following phrases?**
 - (a) present fairly in all material respects
 - (b) give a true and fair view
 - (c) with the foregoing explanation
 - (d) All of the above
2. **..... is 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 the user's understanding of the financial statements.**
 - (a) Emphasis of Matter Paragraph
 - (b) Other Matter Paragraph
 - (c) Key Audit Matter
 - (d) Management Responsibility Paragraph.
3. **Statement 1: Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.**
Statement 2: Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.
 - (a) Only Statement 1 is correct
 - (b) Only Statement 2 is correct
 - (c) Both the statements are correct
 - (d) None of the statement is correct

4. Which of the following is not correct?

- (a) SA 700 - Forming an Opinion and Reporting on the Financial Statements
- (b) SA 701- Key Audit Matters in the Independent Auditor's Report
- (c) SA 705- Comparative Information- Corresponding figures and Comparative Financial Statements
- (d) SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

5. Responsibilities of Joint Auditors are governed by:

- (a) SA 200
- (b) SA 229
- (c) SA 299
- (d) SA 230

Answers to the MCQs based Questions

1. (c) 2. (a) 3. (d) 4. (c) 5. (c)

TRUE/FALSE QUESTIONS

QUESTION-1

The auditor shall express a qualified opinion when:

- a) The auditor concludes that misstatements are material but not pervasive to the financial statements; or
- b) The auditor is unable to obtain sufficient appropriate audit evidence but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

ANSWER

Statement is correct.

The auditor shall express a qualified opinion when:

- a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

QUESTION-2

An auditor should issue disclaimer of opinion when there is difference of opinion between him and the management on a particular point.

ANSWER

Statement is incorrect.

- If the auditor confronts a different stand with the management in respect of a material issue, he should issue a qualified report or express an adverse opinion.

- Disclaimer of opinion is issued when the auditor is not able to frame an opinion due to non availability of sufficient appropriate audit evidences.

QUESTION-3

Joint auditor is always bound by the views of majority of the joint auditors regarding matters to be covered in report.

ANSWER

Statement is incorrect.

SA 299 "Joint Audit of Financial Statements" provides that a joint auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

QUESTION-4

If Financial statements are misstated, and in the auditor's judgment such misstatement is material and pervasive, he should issue a qualified opinion.

ANSWER

Statement is incorrect.

- As per SA 705 "Modification to the Opinion in the Independent Auditor's Report" if financial statements are misstated, and in the auditor's judgment such misstatement is material and pervasive, he should issue an adverse opinion.
- Qualified opinion is issued if financial statements are misstated, and in the auditor's judgment such misstatement is material, but not pervasive.

QUESTION-5

Provision of CARO, 2020 is not applicable to ABC Pvt. Ltd., a subsidiary of XYZ Ltd. (a public company) having fully paid Capital and Reserves & Surplus of 50 lakhs, Secured loan from bank of 90 Lakhs and Turnover of 5 Crore, for the financial year 2023-24.

ANSWER

Statement is incorrect.

- CARO, 2020 is not applicable over a private limited company, not being a subsidiary or holding of a public company, if following conditions are satisfied:
- having a paid-up capital & Reserves & Surplus not more than 1 Cr. as on the balance sheet date, and
- which does not have total borrowings exceeding 1 Cr. 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 Schedule III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding 10 Cr. during the financial year as per the financial statements.
- In this case, CARO is applicable as ABC Pvt. Ltd. is a subsidiary of another public company.

QUESTION-6

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

ANSWER

Statement is incorrect.

- 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.

QUESTION-7

Communicating Key Audit Matters is a substitute for the auditor expressing a modified audit opinion when required by the circumstances of a specific audit engagement in accordance with SA 705.

ANSWER

Statement is incorrect.

Communicating key audit matters in the auditor's report is not 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).

QUESTION-8

The auditor has to report u/s 143 of Companies Act, 2013 whether company has adequate internal controls in place and overall effectiveness of such internal controls.

ANSWER

Statement is incorrect.

- As per Sec. 143 of the Companies Act, 2013, auditor has to report whether the company has adequate internal financial controls with reference to financial statements in place and operating effectiveness of such controls.
- The auditor has to report on adequacy and effectiveness of internal financial controls only and not internal controls.

QUESTION-9

An audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and correct representation of the transactions they claim to represent.

ANSWER

Statement is incorrect.

- The purpose of an audit is to enhance the degree of confidence of intended users of the financial statements. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a true and fair view of the affairs of the entity.
- Thus, an Audit report is an opinion drawn on the entity's financial statements to make sure that from the records are true and fair representation of the transactions they claim to represent.

QUESTION-10

The auditor shall express a qualified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework

ANSWER

Statement is incorrect.

The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable FRF.

QUESTION-11

When the auditor has to express an adverse opinion, he need not communicate with those charged with governance as this may have an impact on payment of his audit fees.

ANSWER

Statement is incorrect.

When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

QUESTION-12

There is no need of addressee in the Auditor's report.

ANSWER

Statement is incorrect.

- The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed.
- The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to TCWG of the entity whose financial statements are being audited.

QUESTION-13

The auditor shall modify the opinion in the auditor's report only when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

ANSWER

Statement is incorrect.

The auditor shall modify the opinion in the auditor's report when:

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

QUESTION-14

The auditor shall express a disclaimer of opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

ANSWER

Statement is incorrect.

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

QUESTION-15

Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.

ANSWER

Statement is incorrect.

- 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 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.

QUESTION-16

Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.

ANSWER

Statement is incorrect.

Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705.

QUESTION-17

The statutory auditor of ABC Ltd. is of the opinion that communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements.

ANSWER**Statement is incorrect.**

As per SA 701 "Communicating Key Audit Matters in the Independent Auditor's Report" communicating key audit matters in the auditor's report is not a substitute for disclosures in the F.S. that the applicable FRF requires management to make, or that are otherwise necessary to achieve fair presentation.

QUESTION-18

Other matter paragraph is 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.

ANSWER**Statement is incorrect.**

Emphasis of Matter paragraph is 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.

QUESTION-19

The auditor shall express an adverse opinion when:

- a) **The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or**
- b) **The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.**

ANSWER**Statement is incorrect.**

The auditor shall express a qualified opinion when:

- a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

QUESTION-20

The concept of "joint audit" has legal foothold under the Companies Act, 2013.

ANSWER**Statement is correct.**

Under provisions of section 139(3), the members of a company may resolve to provide that audit solve to provide shall be conducted by more than one auditor. Hence, the concept of "joint audit" has legal foothold also under Companies Act, 2013

QUESTION-21

Communicating key audit matters in the auditor's report is 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.

ANSWER

Statement is incorrect.

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

QUESTION-22

An auditor has to report on the matters specified in section 143(1) of the Companies Act, 2013.

ANSWER

Statement is incorrect.

Auditor is not required to report on the matters specified in Sec. 143(1) of the Companies Act, 2013 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. However, the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

QUESTION-23

Auditor has to disclose the impact, if any, of the pending litigations on the financial position of the auditee in his audit report.

ANSWER

Statement is incorrect.

Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on - whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

QUESTION-24

Reporting of fraud of INR 150 Lakhs by auditor will be done within three days of the fraud coming to the knowledge of the auditor to the Board or the Audit Committee along with remedial action taken.

ANSWER

Statement is incorrect.

The auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days. Company is bound to disclose remedial action taken in Board's report.

QUESTION-25

The Location of the description of the auditor's responsibilities for the audit of the financial statements is always within the body of the auditor's report.

ANSWER

Statement is incorrect.

The description of the auditor's responsibilities for the audit of the financial statements shall be included:

- a) within the body of the auditor's report; or
- b) within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix; or
- c) by a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

QUESTION-26

Communicating key audit matters in the auditor's report is a separate opinion on individual matters.

ANSWER

Statement is incorrect.

- Key Audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the F.S. of the current period. Key audit matters are selected from matters communicated with TCWG.
- Communicating key audit matters in the auditor's report cannot be considered as a separate opinion on individual matters.

QUESTION-27

Mr. T, the director of A Ltd., has purchased an old car belonging to the company against the cooling equipment belonging to the director, which is given to the company as consideration for the car. The auditor is not required to include this in his CARO report.

ANSWER.

Statement is incorrect.

Para 3(xv) of CARO, 2020 requires the auditor to report whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether provisions of Section 192 of Companies Act, 2013 have been complied with.

QUESTION-28

According to CARO 2020, the company auditor is required to state that whether the title deeds of all immovable properties held in the name of the company are disclosed in its financial statements.

ANSWER

Statement is incorrect.

According to CARO, 2020, the company auditor is required to state 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.

QUESTION-29

Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are detected by obtaining sufficient appropriate audit evidence.

ANSWER

Statement is incorrect.

Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

QUESTION-30

According to Para 3(1)(d) of CARO, 2020, an auditor needs to report 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 5% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.

ANSWER

Statement is incorrect.

According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both company has 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.

CASE SCENARIO

M/s AB & Company is a firm of Chartered Accountants based in Mumbai. Mr. A and Mr. B are the Partners of the Firm. The Firm is engaged in various assignments including Audits. The partners are taking a summary of their work in order to prepare themselves to finalize the Audit and issue the audit report to various clients. You are requested to go through the following and answer the questions that follow:

During the audit of M/s Persistent & Co, Mr. A found that the firm has changed the method of Depreciation from WDV to SLM but has not given the retrospective effect. Mr. A has calculated the difference of depreciation but M/s Persistent & Co. has stated that they don't want to change the financial statements and if auditor persists they may give the effect in the next financial year. During the audit of M/s Dubious Brothers, Mr B observed that the firm had a very large amount of cash sales and there were no details of the customers to whom the sales were made. Further, cash generated was not even deposited into bank regularly. When Mr. B asked the firm to give him an opportunity to count cash, the manager of the firm said that the cash is with the owner and it cannot be made available to the auditor for the checking purpose. The manager also declined to give an opportunity for stock verification to Mr B.

During the audit of M/s Honest & Associates, Mr. A came to know that the firm has changed its method of valuation of stock. This change has a material impact on the financial statement of the firm. The firm has made relevant disclosures in the financial statements and has given proper accounting treatment to this exercise.

➤ ***Based on above, answer following questions:***

Q.1 In case of M/s Persistent & Company, what would be an ideal Audit Opinion?

- a) Unmodified
- b) Qualified
- c) Mention the fact in Emphasis of Matter Paragraph
- d) Disclaimer

Q.2 In case of M/s Dubious Brothers, what Audit Opinion should the Auditor give?

- a) Qualified
- b) Adverse
- c) Disclaimer
- d) Unmodified

Q.3 According to you, what would be appropriate course to take in case of M/s Honest & Associates?

- a) Issue Qualified Opinion
- b) Issue Adverse Opinion
- c) Mention the fact of change in method in Emphasis of Matter Paragraph
- d) Issue Disclaimer of Opinion

Q.4 When the Auditor, after conclusion of an Audit exercise, is of the opinion that there are material misstatements in the Financial Statements, but they are not pervasive, then what should an Auditor

do?

- a) Issue Unmodified Opinion
- b) Issue Qualified Opinion
- c) Issue Disclaimer of Opinion
- d) Mention it in Emphasis of Matter Paragraph

Q.5 When the Auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, Auditor shall give:

- a) Modified Opinion
- b) Qualified Opinion
- c) Disclaimer of Opinion
- d) Unmodified Opinion

Answer

1 (b)

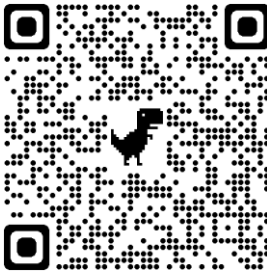

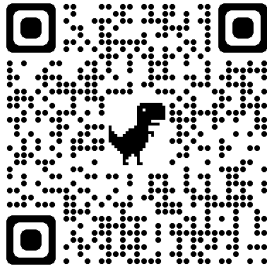

2 (c)

3 (c)

4 (b)

5 (d)

CA NOTES COMMUNITY NETWORK

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Special Features of Audit of Different Types of Entities

STUDY MATERIAL QUESTIONS

QUESTION-1

A society has been formed by pan India employees of a public sector bank. The purpose of society is to promote savings habits of members and to grant loan to them up to a small specified amount. Small savings are promoted amongst members by way of compulsory contribution from monthly ad to salary.

Identify type of society and also discuss nature of books of accounts to be maintained by such a society.

ANSWER

Maintenance Of Books In Case Of Multi-State Cooperative Society

- The society is in nature of Multi-state cooperative society as it serves interests of members in more than one state. It accepts small savings from its members and grants loan to members.
- **As per Multi-State Co-operative Society Rules 2002, every Multi-State Co-operative society shall keep books of account with respect to:**
 - (a) all sum of money received & expended;
 - (b) all sales and purchases of goods;
 - (c) assets and liabilities;
 - (d) in case of Multi State Co-operative Society engaged in production, processing and manufacturing, particulars relating to utilization of materials or labour or other term of cost as specified in bye laws.

QUESTION-2

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

ANSWER

Circumstances When Inquiry May Be Hold Or Ordered

- **Central Registrar may, on a request from**
 - a) a federal cooperative to which multi-state cooperative society is affiliated; or
 - b) a creditor; or
 - c) not less than 1/3rd of the members of the board; or
 - d) not less than 1/5th of the total number of members of a multi-state cooperative society
- hold an inquiry or direct some person authorised by him by order in writing in this behalf to hold an inquiry into the constitution, working and financial condition of a multi-state cooperative society.

QUESTION-3

You are auditor of a school operating in your city. During audit of a year, it is noticed that fees concessions to students have been provided in substantial number of cases.

Discuss, how, you as an auditor, would proceed to verify the same?

ANSWER

Audit Procedure In Case Of A School W.R.T. Fees Concessions:

- Fees concessions have to be under proper authority of school management. Auditor would verify internal controls in this regard.

- Besides, detailed checking of few cases needs to be undertaken to ensure genuineness of fees concessions and proper management approvals.

QUESTION-4

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.

OR

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.

ANSWER

Special Points To Be Examined In Audit Of A Charitable Institution:

- Determine the constitution under which the charitable institution has been established.
- Ensure that the institution is being managed in the manner contemplated by the law under which it has been established.
- Examine the system of internal check, especially as to accounting of receipts.
- Verifying in detail the income and ensure that the amounts received have been deposited in the bank regularly and promptly.

Subscriptions And Donations

- Determine whether any changes made in amount of annual or life membership subscription during the year.
- Ensure the following in relation to official receipts;
 - issue of official receipts
 - adequate control is imposed over unused receipt books;
 - obtain all receipt books covering the period under review;
 - test check the counterfoils with the cash book;
 - cancelled receipts to be specially looked into;
 - obtain the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
 - examine the system of internal check regarding moneys received from box collections, flag days, etc.; and
 - verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

Other Incomes

- Legacies and Grants:** Verify amounts of legacies, grants, charities etc. received by reference to correspondence with any figures and other available information.
- Investment Income:**
 - Vouch amounts received with dividend and interest counterfoils.
 - Check calculations of interest received on securities bearing fixed rates of interest.
 - Check that appropriate dividend has been received where any investment has been sold ex- dividend or purchased cum-dividend.
 - Compare dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.
- Rental Income:** If any property is given or taken on rent, the tenancy agreement should be checked to determine the accuracy of rent received or paid.

d) Income-tax Refunds: Where income-tax has been deducted at source from Investment income, it should be seen that a refund thereof has been obtained since charitable institutions are exempt from payment of Income-tax. This involves:

- Vouching the refund with correspondence with the Income-tax department; and
- Checking the calculation of the repayment of claims.

e) Expenditures

- In any grant is being allowed to any person, verify whether grant have been paid only for a charitable purpose or purposes falling within the purview of the objects.
- Verify 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.
- Verifying the cash and bank balances.
- Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

QUESTION-5

CA Akash Virmani is auditor of a partnership firm consisting of 4 partners. During the year, one of the partners has retired and another partner has joined the next day.

Discuss, any one point, which shall be considered by you to ensure that financial statements of firm are not misstated due to change of constitution of firm.

ANSWER

Considerations In Case Of Change In Constitution Of Firm

- Auditor shall consider provisions of retirement deed/partnership deed for date of retiring and joining of partners. It should be ensured that profits are appropriately distributed up to date of retirement.
- Further, profits after retirement should have been distributed among partners as per terms of new partnership deed.

QUESTION-6

It is the duty of Comptroller and Auditor General of India to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it.

Discuss, in above context, what is understood by "Consolidated Fund of India"? What is its importance?

ANSWER

Consolidated Fund Of India And Its Importance

- Consolidated Fund of India consists of all the revenue received from direct and indirect taxes, all the loans taken by the Govt. of India and all the amount of repayment of loans received by the Govt. of India.
- Its importance lies in the fact that all government expenditure is incurred from this fund. No moneys out of the Consolidated Fund of India shall be appropriated except in accordance with law and for the purposes and in the manner provided in the Constitution.

QUESTION-7

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

ANSWER

Duties of Comptroller and Auditor General:

- 1) **Compilation and submission of Accounts:** C&AG should compile the accounts pertaining to annual receipts and disbursements of the Union or State or Union Territory, and submit these to the President or Governor or Administrator.
- 2) **Rendering Assistance in Accounts Maintenance:** C&AG should provide such information to the Union or State or Union Territory, as they may require from time to time and render such assistance for preparing annual F.S. as they reasonably ask for.
- 3) **Auditing and Reporting:**
The C & AG should audit and report on:
 - a) All the expenditures from Consolidated Fund of India/State/Union Territory having a Legislative Assembly and to determine whether the monies disbursed were legally available for and applicable to the purpose for which they are applied.
 - b) All the transactions of Union or State pertaining to Contingency Funds and Public Accounts.
 - c) All Trading, Manufacturing, Profit & Loss A/cs & Balance Sheets & other subsidiary accounts kept in any department of a Union or State.
- 4) **Audit of Receipts and Expenditure of substantially financed entities:** Where any body or authority is substantially financed by grant or loans from the Consolidated Fund of India/State/Union Territory, C&AG shall audit and report on all receipts and expenditure of that body or authority.
- 5) **Audit of Grants or Loans:** Where any grant or loan is given for any specific purpose from the Consolidated Fund of India/State/Union Territory to any authority or body, not being a Foreign State or International Organisation, C&AG shall scrutinize procedures by which the sanctioning authority satisfies itself as to the fulfilment of the conditions subject to which such grants or loans were given.
- 6) **Audit of Receipts of Union or States:** C&AG shall audit all receipts which are payable into the Consolidated Fund of India/State/Union Territory and satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection & proper allocation of revenue and are being duly observed.
- 7) **Audit of Accounts of Stores and Stock:** C&AG shall have authority to audit and report on the accounts of stores and stock kept in any office or department of the Union/State.
- 8) **Audit of Govt. Companies and Corporations:** Duties and powers of C&AG in relation to audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013.

QUESTION-8

Define Government Audit and explain its objectives.

ANSWER

Government Audit And Its Objectives

- Government auditing may be defined as the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity made subsequently to their execution for the purpose of evaluating and verifying them, presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future actions by the responsible officials and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.
- *Objectives of Government audit includes the following:*
 - a) **Accounting for Public Funds:** Government audit serves as a mechanism or process for public accounting of government funds.
 - b) **Appraisal of Government policies:** It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
 - c) **Base for Corrective actions:** Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.
 - d) **Administrative Accountability:** The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration.

QUESTION-9

Local Fund Audit Wing of a State Government has appointed you to audit the accounts of one of the Local bodies governed by it. As an auditor, what will be your reporting areas?

ANSWER**Important Objectives of local body's audit:**

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

QUESTION-10

In case of Government entities, audit of accounts of stores and inventories has been developed as a Slide part of expenditure audit.

Discuss about the duties and responsibilities entrusted to C&AG.

ANSWER**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.

QUESTION-11

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

ANSWER**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:
 - a) members' applications, counterfoils issued to them, as well as
 - b) on a reference to minutes of the Managing Committee.
- 2) **Subscriptions:** Vouch members' subscriptions with the
 - a) counterfoils of receipt issued to them,
 - b) trace receipts for a selected period to the Register of Members;

c) also reconcile the amount of total subscriptions due with the amount collected and that outstanding.

1) **Arrears of Subscriptions: Ensure that:**

- a) arrears of subscriptions for the previous year have been correctly brought over and
- b) arrears for the year under audit and subscriptions received in advance have been correctly adjusted.

2) **Arithmetical accuracy:** Check totals of various columns of the Register of members and tally them across.

3) **Irrecoverable Member Dues:** 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 for med's amount considered irrecoverable should be mentioned in the Audit Report.

4) **Pricing:** 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.

5) **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.

6) **Purchases:** Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.

7) **Margins earned:** Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that normal rates of gross profit have been earned on their sales. Inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.

8) **Inventories:** Check the inventory of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.

9) **Investments:** Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.

10) **Management Powers:** Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee.

QUESTION-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.

ANSWER

Special Points in audit of Educational Institutions (School):

a) **General**

- 1) In the case of school or college, examine the Trust Deed or Regulations, and note all the provisions affecting accounts.
- 2) In the case of a university, refer to the Act of Legislature and the Regulation framed thereunder.
- 3) 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.

b) **Fee from Students**

- Check names entered in the Students Fee Register and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- Check fees received through comparison of counterfoils of receipts issued with entries in the Cash Book.
- Examine that fee paid in advance, if any, have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- Ensure that admission fees received during the period has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
- Check whether scholarships and concessions are granted by authorised person, having regard to the Rules prepared by the Managing Committee.
- Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
- Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.

c) **Other Receipts/Grants & Donations**

- Verify rental income from landed property with the rent rolls, etc.
- Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- 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.

d) Expenditure

- Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- 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.
- Vouch, all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- Vouch, in the usual manner, all establishment expenses and enquire into any unduly heavy expenditure under any head. If there was any annual budget prepared, see that any excess under any head over the budgeted amount was duly sanctioned by the Managing Committee. If not, bring it to the Committee's notice in your report.
- See that increase in the salaries of the staff have been sanctioned and minute by the Committee.

e) Assets & Liabilities

- Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.
- Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet not transferred to revenue, unless they are not refundable.
- 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.
- Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorized and passed before payment.
- Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.

f) Compliances

- 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.
- Verify annual statements of account and, while doing so examine that separate statements of account have been prepared as regards Economically-weak Students Fund, Games Fund, Hostel and Provident Fund of staff, etc.

QUESTION-13

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

ANSWER

Audit of Donation Receipts:

- 1) **Internal Control System:** Examine internal control system particularly with reference to division of responsibilities in respect of authorized collection of donations, custody of receipt books and safe custody of money.
- 2) **Custody of Receipt Books:** Examine the 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.
- 3) **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.

- 4) **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.
- 5) **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.
- 6) **VI Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of Donations to Different NGOs:

- a) **Mode of Sending Remittance:** Ensure that all remittances are made through account payee Cheques. Remittances through Demand Draft need to be scrutinized thoroughly with reference to recipient.
- b) **Confirming Receipt of Remittance:** Ensure that all remittances are supported by receipts and acknowledgements.
- c) **Identity:** Verify address, Registration Number, etc. of recipient NGO.
- d) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.
- e) **Donation Utilisation:** Ensure that amount of donation is utilised for providing relief to Tsunami victims.
- f) **NGOs' Selection:** Check system for selecting NGO to whom donations have been sent.

QUESTION-14

As an auditor, explain the areas of consideration while auditing the element of ROOM SALES during the audit of a 5-Star Hotel.

ANSWER

Areas Of Consideration While Auditing ROOM SALES During The Audit Of A Hotel

- Charge for room sales is normally posted to guest bills by the receptionist/front office. Source of these entries is invariably the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period. 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.
- In many hotels, housekeeper prepares a daily report of the rooms which were occupied the previous night. 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.
- Ensure compliance with the provisions of FEMA and RBI if receipts are in foreign currency. Ensure application of proper Conversion rate.
- Special emphasis to be laid on receipts through Credit Cards.
- Auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts.
- Auditor should ensure that proper records are maintained for booking of halls and other premises for special parties and recovered on the basis of the tariff.

QUESTION-15

A multi-specialty 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-specialty hospital.

ANSWER

Special Points In Audit Of Books Of Account Of Hospital:

- 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:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For e.g., copies of patient's bill, counterfoils of dividend and other interest warrants, copies of rent bills etc.
- 3) **Income from Investments, rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.

- 4) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- 5) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- 6) **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.
- 7) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- 8) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- 9) **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- 10) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- 11) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- 12) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.
- 13) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

QUESTION-16

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.

ANSWER

The Special Steps Involved In Such An Audit Are Stated Below

- 1) **Entrance Fee :-** 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) **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) **Arrears of Subscriptions :-** 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) **Arithmetical accuracy :-** Check totals of various columns of the Register of members and tally them across.
- 5) **Irrecoverable Member Dues :-** 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) **Pricing :-** 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.
- 7) **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.
- 8) **Purchases :-** Vouch **purchase** of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
- 10) **Margins earned :-** Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal **rates of gross profit** have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.

- 11) **Inventories** :- Check the **inventory** of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.
- 12) **Investments** :- Inspect the share scrips and bonds in respect of **investments**, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.
- 13) **Management Powers** :- Examine the **financial powers of the secretary** and, if these have been exceeded, report specific case for confirmation by the Managing Committee.

QUESTION-17

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.

ANSWER

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 the financial year to which the Statement of Account and Solvency relates.

QUESTION-18

CA Irfan Zaidi is auditor of a prestigious five-star hotel in Jaipur. He notices that there is a gift shop doing brisk business inside the hotel premises.

On further enquiries, he comes to know that stocks in gift shop belong to gift shop owner and hotel receives rent for letting out this space.

Discuss, how, auditor can verify payment of common amenities used by gift shop owner to the hotel.

ANSWER

Verification Of Common Amenities Used By Gift Shop Owner To The Hotel

1. Review the lease agreement between the hotel and the gift shop owner to understand the terms and conditions related to common amenities.
2. Assess the internal controls in place at the hotel and the gift shop to track and report payments for common amenities accurately.
3. Physically observe the common amenities and inquire about their usage with both the hotel management and the gift shop owner.
4. Obtain a breakdown of common expenses incurred by the hotel, including maintenance, security, utilities, and shared amenities.
5. Communicate with hotel management to confirm the receipt of payments from the gift shop owner for common amenities.
6. Review invoices and contracts from vendors providing common amenities to ensure that the gift shop owner is meeting their financial obligations.

QUESTION-19

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?

ANSWER

Points To Be Concentrated While Planning An Audit Of An NGO:

- 1) Knowledge of the NGO's work, its mission and vision, areas of operations & environment in which it operates.
- 2) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 2010, Societies Registration Act, 1860, Income-tax Act 1961 etc.
- 3) Reviewing its legal form and its MOA, AOA, rules and Regulations.
- 4) Reviewing the Organisation chart, Manuals relating to financial and administrative matters.

- 5) Examination of minutes of meetings of Managing Committee/ Governing Body to ascertain the impact of decisions on the financial records.
- 6) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- 7) Setting of materiality levels for audit purposes.
- 8) Nature and timing of reports or other communications.
- 9) Involvement of experts and their reports.
- 10) Review the previous year's Audit Report.

QUESTION-20

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?

ANSWER

Special Points in Audit of books of account of Hospital:

- 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:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For e.g., copies of patient's bill, counterfoils of dividend and other interest warrants, copies of rent bills etc.
- 3) **Income from Investments, rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.
- 4) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- 5) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- 6) **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.
- 7) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- 8) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- 9) **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- 10) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- 11) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- 12) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.
- 13) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

QUESTION-21

You are auditing the Books of accounts of Karla Multiplex which runs 15 Film shows every day. 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.

ANSWER

1. Review the agreement between Karla Multiplex and film distributors to understand the terms and conditions governing the relationship.
2. Confirm that the agreement clearly outlines the rights and obligations of both parties regarding film screenings.
3. Ensure that the multiplex has the proper rights to exhibit the films and that it complies with licensing agreements.
4. Examine the revenue sharing structure between the multiplex and film distributors. Verify the agreed-upon percentage or fixed amount for each film screening.
5. Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.
6. Confirm that any film rental advances or deposits required by the distributors are properly accounted for and recorded in the books.
7. Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable
8. Ensure a provision in respect of advances that are considered irrecoverable are being made by the management.

MCQS BASED QUESTIONS

- (1) The audit of municipal corporation of a large metro city is in progress. Which of the following is not likely an objective of such as audit?**
- (a) To report on the adherence to legal and administrative requirements
 - (b) To report on whether value is being fully received for money spent
 - (c) To report on the weakness of systems of financial control
 - (d) To provide better civic amenities to residents of metro city
- (2) "Save Democracy" is an NGO working in cause of promoting democracy and democratic institutions in many countries including India. Its Indian counterpart has received funds from a renowned "Flower Trust" of US. As auditor of NGO, which of the following laws/orders would be relevant to you in context of above information?**
- (a) Income Tax Act, 1961
 - (b) Foreign Contribution Regulation Act, 2010
 - (c) Companies Act, 2013
 - (d) Orders issued by Ministry of Social Justice and Empowerment
- (3) The appointment of first auditor of a multi-state cooperative society is made by: -**
- (a) Central Registrar
 - (b) Board of society
 - (c) Members of society
 - (d) Central Government
- (4) Consider following revenue sources of Union Government.**

- (P) Revenues from direct taxes
- (Q) Revenues from Goods and Services Tax
- (R) Revenues from Custom Duties
- (S) Revenues from Excise Duties

Out of P, Q, R and S, which of the following flow to “Consolidated Fund of India”?

- (a) P, Q and R
- (b) P, Q and S
- (c) P and Q
- (d) P, Q, R and S

(5) An LLP files compliance returns with: -

- (a) Registrar of firms & societies
- (b) Central Registrar
- (c) Registrar of Companies
- (d) Local fund audit wing

Answers to the MCQs based Questions

1. d 2. b 3. b 4. b 5. c

TRUE/FALSE QUESTIONS

QUESTION-1

The Comptroller and Auditor General does not have any authority to audit the accounts of stores and inventory kept in any office or department of the Union or of a State.

ANSWER

Statement is incorrect.

- The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.
- 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.

QUESTION-2

An Operating Lease is a kind of Financing arrangement.

ANSWER

Statement is incorrect.

A Finance Lease is a Financing arrangement. An Operating lease, on the other hand, is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.

QUESTION-3

An auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts in the case of audit of a Hotel.

ANSWER

Statement is correct.

The auditor should ensure that proper valuation of occupancy-in progress at the balance sheet date is made and included in the accounts for proper recording of closing and opening entries and maintenance of accounts on Accrual basis as per the Matching concept.

QUESTION-4

Small LLPs are mandatorily required to get their Books of account audited.

ANSWER

Statement is incorrect.

- Accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009, which provide that any LLP whose turnover does not exceed, in any financial year, 40 lakh, or whose contribution does not exceed 25 lakh, is not required to get its accounts audited.
- Further, a Small LLP is any LLP the Contribution of which, does not exceed 25 lakh or such higher amount, not exceeding 5 crore, as may be prescribed; and the Turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed * 40 lakh or such higher amount, not exceeding 50 crore, as may be prescribed.
- Hence, the provisions of audit are not applicable on Small LLP's. Therefore, the Small LLPs can prepare its financial statement merely with the signatures of the Designated Partners.

QUESTION-5

The external control of municipal expenditure is exercised by the Central Government through the appointment of auditors to examine municipal accounts.

ANSWER

Statement is incorrect.

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.

QUESTION-6

The auditor of an LLP may be appointed by the Designated Partners or other Partners whosoever is available at the time of appointment.

ANSWER

Statement is incorrect.

The auditor is to be appointed by the designated partners of the LLP. However, the Partners may appoint the auditors only if the Designated Partners have failed to appoint them.

QUESTION-7

The first auditor of a Multi-state Co-operative Society will be appointed in AGM.

ANSWER

Statement is incorrect.

- Sec. 70 of the Multi-state Co-operative Societies Act, 2002 provides that the first auditor of a Multi- state co-operative society shall be appointed by the board within one month of the date of registration of such society.

- If the board fails to appoint first auditor, the Multi-state co-operative society in the general meeting may appoint the first auditor.

QUESTION-8

Article 151 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.

ANSWER

Statement is incorrect.

Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.

QUESTION-9

LLP need not file a "Statement of Accounts and Solvency".

ANSWER

Statement is correct.

It is the function of audit to establish that payments have been made validly to persons who are shown to be recipients. For checking the validity of a transaction, it is usually necessary to refer to documentary evidence.

QUESTION-10

Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the Finance Minister may on the advice of the C&AG prescribe.

ANSWER

Statement is incorrect.

Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.

QUESTION-11

All Non-Governmental Organisations (NGOs) are allowed to maintain accounts either on accrual basis or cash basis.

ANSWER

Statement is incorrect.

- NGOs registered under the Companies Act, 2013 must maintain their books of account under the accrual basis as required by the provisions of Sec. 128 of the said Act. If the accounts are not maintained on accrual basis, it would amount to non-compliance of the provision of the Companies Act, 2013.
- The NGOs which are not registered under the Companies Act, 2013 are allowed to maintain accounts either an accrual basis or cash basis.

QUESTION-12

Every LLP is required to submit Statement of Account and Solvency in Form 8, which shall be filed within a period of sixty days from the end of three months of the financial year to which the Statement of Account and Solvency relates.

ANSWER

Statement is incorrect.

- As per Sec. 34 of LLP Act, 2008, every LLP shall, within a period of six months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year in prescribed form, and such statement shall be signed by the designated partners of the LLP.
- As per Rule 24 of LLP Rules, 2009, Statement of Account and Solvency shall be filed in Form 8 with the Registrar, within a period of 30 days from the end of 6 months of the financial year to which the Statement of Account and Solvency relates

QUESTION-13

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.

ANSWER

Statement is correct.

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 i.e. the expenditure is incurred with due regard to broad and general principles of financial propriety.

QUESTION-14

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.

ANSWER

Statement is correct.

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. mostly related to civic amenities and local area development and maintenance.

QUESTION-15

NGOS may be defined as non-profit making organisations which raise funds from members, donors or be contributors apart from receiving donation of time, energy and skills for achieving their social objectives.

ANSWER

Statement is correct.

- NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations.
- These would include religious organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc. The scope of services rendered by NGOs is extremely wide.

QUESTION-16

The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.

ANSWER

Statement is incorrect.

The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013.

QUESTION-17

Before holding inquiry by the Central Registrar thirty days' notice must be given to the Multi-state co-operative society.

ANSWER

Statement is incorrect.

Before holding inquiry by the Central Registrar 15 days notice must be given to the Multi State co- operative society.

QUESTION-18

According to 'Audit of sanctions', 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.

ANSWER

Statement is incorrect.

- 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.
- According to '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. Ins as mot done.

QUESTION-19

In the case of Co-operative societies, contribution to Education fund is a charge on profits and not an appropriation.

ANSWER

Statement is correct.

Some of the State Acts provide that every society shall contribute annually towards the Education Fund of the State Federal Society, at the appropriate rate as per the class of the society. Contribution to Education Fund is a charge on profits and not an appropriation.

QUESTION-20

Comptroller and Auditor General of India can be removed by the Prime Minister of India on the recommendation of his Council of Ministers.

ANSWER

Statement is incorrect.

- The Comptroller and Auditor General of India cannot be removed by the Prime Minister of India on the recommendation of his Council of Ministers.
- He can be removed on the ground of proven misbehaviour or incapacity, when each House of Parliament decides to do so by majority of not less than 2/3 of the members of the house present and voting.

QUESTION-21

The accounts of every LLP shall be audited in accordance with rule 24 of LLP Rules, 2009.

ANSWER

Statement is correct.

- Sec. 34 of LLP Act, 2008 states that Accounts of LLP shall be audited in accordance with such rules as may be prescribed.
- Rule 24 of LLP Rules, 2009 provides the detailed provisions in this regard, in accordance with which a LLP whose turnover does not exceed, in any financial year, 40 Lacs, or whose contribution does not exceed 25 Lacs shall not be required to get its accounts audited.
- However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rules.

QUESTION-22

LLP need not file a "Statement of Accounts and Solvency".

ANSWER

Statement is incorrect.

- As per Sec. 34 of LLP Act, 2008, Statement of Account and Solvency shall be filed with the Registrar every year in such form and manner and accompanied by prescribed fees.
- As per Rule 24 of LLP Rules, 2009, Statement of Account and Solvency shall be filed in Form 8 with the Registrar, within a period of 30 days from the end of 6 months of the financial year to which the Statement of Account and Solvency relates.

QUESTION-23

The Constitution of India contains no specific provisions regarding the appointment, salary and duties and powers of the C&AG. Moreover, the constitution does not guarantee the independence of the C&AG of India.

ANSWER

Statement is incorrect.

The Constitution of India contains specific provisions regarding the appointment, salary and duties and powers of the C&AG. The constitution guarantees the independence of the C&AG of India by prescribing that he shall be appointed by the President of India and shall not be removed from office except on the ground of proven misbehaviour or incapacity.

CASE SCENARIO

Consider the following five descriptions:

(A) Audit of "Implementation of Nagpur Metro Rail Project" was conducted by the Comptroller and Auditor General of India.

Following is extract of few audit findings placed on website cag.gov.in.

"The location of New Airport station was not ideal from the viewpoint of ridership due to sparse population in and around the station and also from the accessibility point of view.

Cotton Market station, the second additional station was projected to have high peak hour peak direction trips but the work was kept on hold midway citing fund crunch due to non-release of pending contribution from stakeholders. However, the situation could have been managed through prioritization of works."

(B) Special Features of Audit of Different Types of Entities Another set of audit findings in respect of audit of Haryana Power Generation Corporation Limited, a wholly owned government company responsible for operation of power generation plants in state of Haryana is as under: -

"The main reason for low generation was higher variable cost of thermal power stations which resulted in backing down of plants."

(C) A report was tabled in Parliament highlighting main features of direct taxes administration of country as mandated in Constitution of India. This report primarily discussed compliance to the provisions of the Income Tax Act, 1961 and the associated rules and procedures etc. as applied to administration of direct taxes including irregularities noticed in finalizing assessments etc.

(D). Radial finance corporation Limited is a government company. The audit of the company is conducted by statutory auditors appointed by Comptroller and Auditor General of India.

(E) Bharat Insurance Company Limited is a general insurance government owned company. The statutory auditor is appointed by Comptroller and Auditor General of India.

The annual report for a particular year also contains comments of statutory auditors on matters such as whether company has carried out reconciliations in respect of its inter-company balances with other government owned insurance companies.

➤ ***Based on above, answer following questions:***

Q.1 Based upon plain reading of audit findings stated at Para (A), identify type of audit carried out by office of the Comptroller and Auditor General of India.

- a) Audit against provision of funds
- b) Propriety audit

- c) Performance audit
- d) Compliance audit

Q.2 Keeping in view audit findings in respect of Haryana Power Generation Corporation Limited, identify type of audit carried out.

- a) Audit of Government Company
- b) Audit against rules and orders
- c) Compliance audit
- d) Performance audit

Q.3 Which of the following is the most appropriate statement in context of report tabled in Parliament regarding administration of direct taxes?

- a) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Comptroller and Auditor General of India.
- b) It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by an independent task force of experts.
- c) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Central Board of Direct Taxes.
- d) It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by Central Board of Direct Taxes.

Q.4 Who is empowered to conduct "supplementary audit" in case of Radial Finance Corporation Limited, a government company?

- a) Central Government
- b) Another independent auditor appointed by CAG
- c) CAG
- d) Another independent auditor appointed by Ministry of Corporate Affairs

Q.5 As regards comments of auditors specified in respect of audit report of above insurance company, which of the following is likely to be most appropriate statement?

- a) Such are likely to be comments of test audit carried out by CAG.
- b) Such are likely to be comments in respect of directions to statutory auditor by CAG for reporting on specific aspect of their audit work.
- c) Such are likely to be comments of supplementary audit carried out by CAG
- d) Such are likely to be comments of statutory auditors in accordance with requirements of Standards on Auditing

Answer

1 (c)


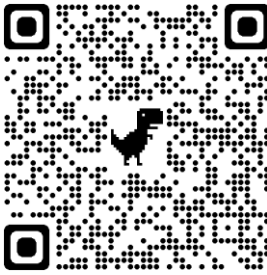


2 (d)

3 (a)

4 (c)

5 (b)

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STUDY MATERIAL QUESTIONS

QUESTION-1

You are verifying interest on deposits paid by branch of a nationalized bank. Discuss, any two "analytical procedures", to verify interest on deposits paid by branch.

ANSWER

Analytical Procedures", To Verify Interest On Deposits

- 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.
- Also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyze any material differences.

QUESTION-2

Account of a borrower availing cash credit facility from branch of a bank has become "Out of order." Discuss the term "Out of order"

ANSWER

Out Of Order In Relation To Classification Of Advances

- **An account should be treated as 'out of order' if:**
 - a) outstanding balance remains continuously in excess of the sanctioned limit/drawing power; or
 - b) if there are no credits continuously for 90 days as on the date of Balance Sheet; or
 - c) credits are not enough to cover the interest debited during the same period.
- **Example:** A Ltd. has been sanctioned a Cash Credit Facility by ADB Bank Ltd. for 50 lacs but as per the Stock Statements furnished for the last quarter the Bank has calculated the Drawing power to be 42 Lakhs.
- In this case, the account would be **termed as OUT OF ORDER if:**
 - a) outstanding balance remains continuously in excess of 50 lacs/42 lacs whatever the case may be; or
 - b) outstanding balance in the account is less than 42 lacs but there are no credits or any payments deposited into this account continuously for 90 days as on the date of Balance Sheet; or
 - c) credits are there upto say 2 lakhs but are not enough to cover the interest debited during the same period which is around 5 lakhs.

QUESTION-3

Ranjana Ceramic Private Limited is sanctioned a cash credit facility of 100 lacs from a branch of LMO Bank. Besides, branch has also sanctioned a one-time bank guarantee of ₹ 10 lacs on behalf of the company in favour of a statutory authority.

Discuss, what type of credit facilities have been sanctioned by branch of LMO bank to the company along with probable purpose for each of credit facility.

ANSWER

Classification Of Advances

- Cash credit facility sanctioned by bank to company is in nature of funded credit facility. Its purpose is to meet working capital requirements of business.

- Bank guarantee sanctioned to the company is in nature of non-funded credit facility. Its probable purpose could be requirement of a guarantee by a statutory authority in exchange of company fulfilling some statutory obligations.

QUESTION-4

Is statutory auditor of a bank required to report on the requirements relating to Companies (Auditor's Report) Order, 2020?

ANSWER

Reporting On The Requirements Of CARO, 2020

Reporting requirements relating to the CARO 2020 is not applicable to a banking company.

QUESTION-5

Discuss importance of implementation of KYC norms by a bank from perspective of an auditor of bank.

ANSWER

Importance Of Implementation Of KYC Norms

- 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 ("KYC Guidelines Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

QUESTION-6

The financial statements of a bank are prepared in a specified format. Discuss legal provisions in this regard as applicable to financial statements of a nationalized bank.

ANSWER

Form and Content of F.S.

- As per Sec. 29 of the Banking Regulations Act, 1949 deal with the form and content of financial statements of a banking company and their authentication. These provisions are also applicable to nationalised banks.
- Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit.
- Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.

QUESTION-7

List out any four points which highlight peculiarities involved in banking operations.

ANSWER

Peculiarities Involved In Banking Operations

- Voluminous and complex transactions,
- Wide geographical spread of banking network,
- Diversified and large range of products and services offered,
- Extensive use of technology,
- Strict vigilance and compliance.

QUESTION-8

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

ANSWER**Rbi - Regulating Body**

In India, banking industry is regulated by the Reserve Bank of India (RBI) known as the Central Bank.

RBI is responsible for:

- (a) development and supervision of the banks and non-banking financial institutions
- (b) determining the monetary and credit policies.
- (c) to regulate the activities of commercial and other banks.

Important functions of RBI are:

- (a) issuance of currency;
- (b) regulation of currency issue;
- (c) acting as banker to the Central and State governments, commercial and other types of banks including term-lending institutions.

QUESTION-9

During course of audit of branch of a nationalized bank, you find that system has generated a report marking ten term loan accounts as SMA. Discuss, meaning of SMA accounts and significance of such a classification.

ANSWER**Special Mention Accounts (SMA)**

- Special Mention Account (SMA) is an account which is exhibiting signs of incipient stress resulting in the borrower defaulting in timely servicing of debt obligations, though the account has not yet been classified as NPA as per the RBI guidelines.
- In case of SMAs, there are over dues for a period of 0 to 90 days. Since period of 90 days has not been exceeded as on the date, such accounts have not been classified as NPA as per RBI norms.
- Such a classification is significant as early recognition of such accounts enables banks to initiate timely remedial actions to prevent potential slippages of such accounts into NPAs.

QUESTION-10

CA P is conducting stock audit of a borrower availing cash credit facility of 100 lacs from branch of a bank. The cash credit facility is against security of paid stocks and debtors up to 90 days. Margin stipulated is 25% for stocks and 40% for debtors.

Following further information is available as on 31.12.23:

Value of stocks	125 lacs
Value of stocks (fully damaged) included in above	5 lacs
Value of debtors	50 lacs
Value of debtors exceeding 90 days included in above	10 lacs
Value of creditors for goods	50 lacs

Is Drawing Power computed by CA P for ₹ 82.50 lacs proper?

ANSWER**Computation of Drawing Power**

	rupee
Value of stocks as on 31.12.23	125 lacs
Less: value of damaged stocks	5 lac
	120 lacs
Less: creditors for goods as on 31.12.23	<u>50 lacs</u>
Value of Paid stocks	70.00 lacs
Less: Margin @ 25%	17.50 lacs
Drawing power (A)	52.50 lacs
Value of debtors as on 31.12.23	50 lacs
Less: debtors exceeding 90 days	<u>10 lacs</u>
	40 lacs
Less: Margin @ 40%	16 lacs
Drawing Power (B)	24 lacs
Drawing Power (A+B)	76.50 lacs

Conclusion:

Drawing power calculated by CA P is not proper. Drawing Power comes to 76.50 lacs.

QUESTION-11

Discuss outline of audit approach including audit procedures while auditing “provisions and contingencies” in financial statements of a bank.

Or

You are appointed as statutory audit of DEF Bank Limited for the year 2023-24. As an auditor how will you verify provision created by DEF Bank Limited?

ANSWER**Audit Procedure For Verification Of Provisions And Contingencies**

- (1) Ascertain compliance with the various regulatory requirements for provisioning as contained in the various circulars.
- (2) Obtain an understanding as to how the Bank computes provision on standard assets and non- performing assets. It includes the basis of the classification of loans into standard, sub-standard, doubtful and loss assets.
- (3) Obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balance with the general ledger.
- (4) Obtain statement of computation of tax provision 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.
- (5) Other provisions for expenditure should be examined vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

QUESTION-12

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

ANSWER

Engagement Team Discussions

Engagement team should hold discussions to gain better understanding of banks 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. The discussion should be done on the susceptibility of the bank's financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

Benefits Of Discussion:

- Specific emphasis should be provided to susceptibility of bank's F.S. to material misstatement due to fraud, that enables the ET to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- Enables EP to delegate the work to experienced ET members, and to determine the procedures to be followed when fraud is identified.
- EP may review the need to involve specialists to address the issues relating to fraud.

Matters To Be Discussed

- a) Errors that may be more likely to occur;
- b) Errors which have been identified in prior years;
- c) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- d) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- e) Need to maintain professional skepticism throughout the audit engagement;
- f) Need to alert for information or other conditions that indicates that a material misstatement may have occurred.

QUESTION-13

Write a short note on reversal of income under bank audit.

ANSWER

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.

MCQS BASED QUESTIONS

(1) Which of the following is included in "Interest Earned" in Profit & loss A/c of a bank?

- (a) Discount on Bills

- (b) Loan Processing fees
- (c) Commission on bills for collection
- (d) Credit Card Fees

(2) While auditing advances of a bank as statutory auditor, which of the following is not a likely concern of auditor?

- (a) Appropriate documentation of advances
- (b) Ensuring budgeted targets of advances given by bank management
- (c) Compliance of sanctioned terms and conditions
- (d) Operations in advance accounts

(3) Any amount due to the bank under any credit facility is 'overdue' if: -

- (a) it is not paid on the due date fixed by the bank
- (b) it is not paid within 30 days of due date fixed by the bank
- (c) it is not paid within 60 days of due date fixed by the bank
- (d) it is not paid within 90 days of due date fixed by the bank

(4) Which of the following statement is true regarding appointment of statutory branch auditor of a nationalized bank?

- (a) The appointment is made by bank acting through its board of directors with prior approval of Central govt.
- (b) The appointment is made by bank acting through its board of directors with prior approval of RBI
- (c) The appointment is made by bank acting through its board of directors with prior approval of ICAI
- (d) The appointment is made by shareholders in AGM.

(5) Identify the correct statement: -

- (a) Income from non-performing assets is recognized on accrual basis
- (b) Income from non-performing assets is never recognized.
- (c) Income from non-performing assets is recognized on basis of actual recovery
- (d) Income from non-performing assets is recognized only when such assets are upgraded to standard assets

Answers to the MCQs based Questions

1. a 2. b 3. a 4. b 5. c

TRUE/FALSE QUESTIONS

QUESTION-1

Classification as NPA should be based on the availability of security and asset classification would be facility wise and not borrower wise.

ANSWER**Statement is incorrect.**

- 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.
- Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

QUESTION-2

The policy of income recognition, in case of a Bank, should be subjective.

ANSWER**Statement is incorrect.**

The policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Income from Non-Performing Assets (NPA) is not recognized on accrual basis but is booked as income only when it is actually received.

QUESTION-3

The assignment is the creation of an equitable charge which is created in favour of the lending bank by execution of hypothecation agreement in respect of the movable securities belonging to the borrower.

ANSWER**Statement is incorrect.**

- 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 movable securities belonging to the borrower.
- Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favour of another person.

QUESTION-4

Collateral 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.

ANSWER**Statement is incorrect.**

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. Collateral security is an additional security. Security can be in any form i.e. tangible or intangible asset, movable or immovable asset.

QUESTION-5

A loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.

ANSWER**Statement is incorrect.**

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. 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.

QUESTION-6

It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the RBI and agreed upon by the concerned statutory auditors.

Special consideration need not be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

ANSWER

Statement is incorrect.

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.

QUESTION-7

RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.

ANSWER

Statements is incorrect.

RBI has been entrusted with the responsibility of regulating the activities of entire banking system in India which covers commercial as well as other banks.

QUESTION-8

In the computerized environment, the auditor is not required to be familiar with latest applicable RBI guidelines that have bearing on the classification/ provisions and income recognition.

ANSWER

Statement is incorrect.

While carrying out audit of a bank whether in a Computerized environment or manual, auditor must be familiar with all the norms/parameters as per the latest applicable RBI guidelines that have a bearing on the classification/provisions and income recognition.

QUESTION-9

Collateral security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank.

ANSWER

Statement is incorrect.

- Security offered by the borrower for bank finance or the one against which credit has been extended by the bank is known as primary security.
- Collateral security is an additional security and can be in any form i.e. tangible or intangible asset, movable or immovable asset.

QUESTION-10

Registered mortgage is affected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

ANSWER

Statement is incorrect.

- Registered Mortgage can be affected by a 'Mortgage Deed' signed by the mortgagor.
- Equitable mortgage, is affected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

QUESTION-11

Any amount due to the bank under any credit facility is 'overdue' if it is not paid within 90 days of becoming due.

ANSWER

Statement is incorrect.

An amount is said to be 'Overdue', if it is not paid on the due date fixed by the Bank.

QUESTION-12

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

ANSWER

Statement is correct.

- An account should be treated as 'Out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power, or
- If there are no credits continuously for 90 days as on the balance sheet date or the credits are not enough to cover the interest debited during the same period.

QUESTION-13

The auditor can assume that the system generated information is correct and relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

ANSWER

Statement is incorrect.

The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

QUESTION-14

Reporting of fraud of INR 150 Lakhs by auditor will be done within three days of the fraud coming to the knowledge of the auditor to the Board or the Audit Committee along with remedial action taken in case of audit of ABA Bank Ltd.

ANSWER

Statement is incorrect.

Auditor shall report the matter to the Board or the Audit Committee immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days. The Banking Company is bound to disclose remedial action taken in Board's report.

QUESTION-15

Central Govt. guaranteed Advances, where the guarantee is not invoked/repudiated would be classified as Standard Assets.

ANSWER

Statement is correct.

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.

QUESTION-16

The matters which the banks require their auditors to deal with in the long form audit report have been specified by the Central Government.

ANSWER

Statement is incorrect.

The matters which the banks require their auditors to deal with in the long form audit report have been specified by the Reserve Bank of India.

QUESTION-17

Banks recognize income on Non-Performing Assets on accrual basis.

ANSWER

Statement is incorrect.

In case of NPA, RBI guidelines require that banks should not recognize income until it is actually realised.

QUESTION-18

Auditor of a nationalized bank is to be appointed at the annual general meeting of the shareholders.

ANSWER

Statement is incorrect.

Auditor of a nationalized bank is to be appointed by the bank concerned acting through its Board of Directors.

QUESTION-19

An account should be treated as 'out of order' if outstanding balance remains continuously in excess of sanctioned limit/drawing power. 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 180 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

ANSWER

Statement is incorrect.

- An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.
- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

CASE SCENARIO

- (1) CA M is conducting statutory audit of branch of MMC Bank. During the course of audit, it is noticed as under: Loans under "Kisan credit card" are given by Bank to farmers to meet their short-term credit needs for cultivation of crops. In respect of one agricultural advance classified under "Kisan Credit Card" having an outstanding balance of ₹ 20 lacs as at year end, there is no transaction in account since last 90 days. The said loan has been granted for cultivation of paddy which is harvested in a period of 3-4 months from sowing. The branch has classified the said advance as "Standard asset".
- (2) It is also observed that account of one borrower availing cash credit limit of ₹ 50 lacs was taken over from another bank. The proposal was sanctioned by branch manager instead of immediate next higher authority as required in "Manual of Delegation of Powers" of Bank.
- (3) It is noticed that head office of bank has flagged a savings account maintained in branch in which interest was wrongly paid at higher rate due to wrong data feeding entry. Now, situation has been rectified by debiting excess interest paid in the account. Since there was little balance in savings account, a debit balance of ₹ 1.50 lac was

created in the said savings account due to above reversal. The matter was immediately informed to account holder. However, he has not turned up for payment since matter was informed to him about six months ago.

- (4) There are many cash credit accounts in the branch. Such borrowers are required to submit monthly stock statements to branch showing calculation of drawing power.
- (5) One borrower has availed a housing loan and a car loan from the branch. Housing loan EMIs are overdue for 120 days as on date of Balance sheet. Car loan EMIs are overdue for 60 days as on date of Balance sheet.

➤ **Based On Above, Answer Following Questions:**

Q.1 Audit of Banks As regards description of agricultural advance, which of the following statements is most appropriate in this regard?

- a) The branch has erred in making classification as per RBI norms. It is a "Sub-standard" asset.
- b) The classification made by branch is proper. However, there are no transactions in account since last 90 days, it is SMA.
- c) The classification made by branch is proper.
- d) The branch has erred in making classification as per RBI norms. It is a "doubtful" asset.

Q.2 Regarding taken over account from another bank, which of following statements is most appropriate?

- a) It is an internal issue of Bank and auditor is not concerned with it.
- b) It is an internal issue of Bank. However, the auditor may, at his discretion, report it.
- c) It is a serious violation of laid down procedures of bank for sanction of advances and should be reported by auditor without fail.
- d) There is no issue involved as credit facility was properly sanctioned.

Q.3 As regards debit balance of ₹ 1.50 lacs in Savings account, which of the following is correct from point of view of an auditor?

- a) The situation does not attract RBI norms on asset classification.
- b) The debit balance of 1.50 lacs should be classified as NPA.
- c) The situation does not attract RBI norms on asset classification as no credit facility was granted.
- d) The bank cannot demand excess interest paid to account holder.

Q.4 Which of the following statements is not true about "Drawing Power" (DP)?

- a) Drawing Power refers to the amount calculated based on primary security less margin as on particular date.
- b) It is always less than sanctioned limit.
- c) It can be different from sanctioned limit.
- d) Creditors for goods are reduced for purpose of calculating Drawing Power.

Q.5 Considering housing loan and car loan availed by a borrower, which of the following statements is appropriate?

- a) Both Housing loan as well as car loan should be classified as "Non - Performing Assets" in accordance with RBI norms on asset classification.
- b) Housing Loan should be classified as "Non-Performing Asset" in accordance with RBI norms on asset classification. However, Car loan should be classified as Standard asset.
- c) Car Loan should be classified as "Non-Performing Asset" in accordance with RBI norms on asset classification. However, Housing Loan should be classified as Standard asset.
- d) Both Housing as well as car loans should be classified as Standard assets.

Answer

1 (c)

2 (c)

3 (b)

4 (b)

5 (a)

STUDY MATERIAL QUESTIONS

QUESTION-1

CA Raman Gupta is offered appointment as auditor of a company. One of his distant uncles held some shares in the same company. Holding of such shares, by a distant relative, is not prohibited under provisions of law nor does it affect his independence.

Before he could accept appointment, he received unfortunate news of death of his uncle who had died without any children. He came to know that he was nominee of these shares having substantial value. It landed him in a tricky situation.

What should be proper course of action for him?

ANSWER

Safeguards To Independence

- When threats to independence exist, auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level.
- Holding of shares involves financial interest in the company and is in nature of self-interest threat. He has come to hold shares due to nomination made by his distant relative before accepting the appointment.

- **Conclusion:**

Considering above, CA Raman should take steps to eliminate the threat by selling shares immediately before accepting appointment. Holding of shares of the same company for which he is offered appointment as auditor constitutes threat to his independence.

QUESTION-2

A Chartered accountant receives about 40% of his total audit fees from a single client. Discuss how it could affect independence of Chartered accountant as auditor of this client.

What are such types of threats referred to as?

ANSWER

Threats to Independence:

Undue dependence on fees of a client constitutes a threat as there is fear of losing the client. Such threats are referred to as self-interest threats.

Self-interest threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include:

- a) direct financial interest or materially significant indirect financial interest in a client;
- b) loan or guarantee to or from the concerned client;
- c) undue dependence on a client's fees and, hence, concerns about losing the engagement;
- d) close business relationship with an audit client;
- e) potential employment with the client; and
- f) contingent fees for the audit engagement.

QUESTION-3

CA Murli Madhavan provides accounting and book keeping services to a leading NGO engaged in environmental protection work. He is also offered audit of the accounts of NGO.

Identify and discuss what kind of threat to independence may be involved in accepting such an engagement.

ANSWER

Threats to Independence

- In this case, Chartered Accountant is already rendering accounting and book keeping services to an NGO. If he accepts audit, he would be involved in reviewing own work.
- Therefore, the same constitutes "self-review" threat.
- **It may occur when a previous judgment needs to be re-evaluated by the professional accountant responsible for that judgment. Instances where such threats may arise are:**
 - a) when an auditor having recently been a director or senior officer of the company; and
 - b) when auditors perform services that are themselves subject matters of audit.

QUESTION-4

The auditors of a company have only relied upon management representation letter regarding 2297bb treatment of certain tax matters under appeal by the company.

The auditors have not carried out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements.

What is lacking on part of auditors in such a situation?

ANSWER

Professional Skepticism

- In the given case, auditors have relied only upon management representation letter regarding In treatment of certain tax matters under appeal by the company. No other audit procedures to verify management's treatment of such matters under appeal have been performed by auditors.
- It shows lack of "professional skepticism" on part of auditors.

QUESTION-5

How application of professional skepticism throughout audit is helpful in reducing audit risk?

ANSWER

Professional Skepticism

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.

It Reduces risk of:

- a) Overlooking unusual circumstances.
- b) Over generalizing when drawing conclusions from audit observations.
- c) Using inappropriate assumptions in determining NTE of audit procedures & evaluating the results thereof.

QUESTION-6

CA P. Suryakantam has conducted audit of accounts of an entity for a particular year. ICAI has issued a letter to him relating to certain matters concerning audit.

He didn't even bother to reply to the letter despite reminders. Discuss which fundamental principle governing professional ethics is disregarded by him.

ANSWER

Fundamental Principles Governing Professional Ethics

- "Professional Behaviour" requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession.
- Failure to reply to professional body smacks of lack of courtesy and professional responsibility.

- **Conclusion:** The principle of "Professional behaviour" is disregarded.

QUESTION-7

A Chartered accountant in practice issued a certificate showing original cost of plant and machinery installed in premises of a client for ₹ 9 crores to save some regulatory fees for his client. However, 1360 original cost of plant and machinery was ₹ 15 crores as per records of client.

Which fundamental principle governing professional ethics is violated in this case?

ANSWER

Fundamental Principles Governing Professional Ethics

- Integrity requires that a professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information
 - a) contains a materially false or misleading statement;
 - b) contains statements or information provided negligently or omits or obscures required information where such omission or obscurity would be misleading.
- In the given case, a false certificate is knowingly issued showing misstated original cost of machinery. Therefore, fundamental principle of "integrity" is violated.

QUESTION-8

Briefly outline how principles-based approach differs from rules-based approach to ethics.

ANSWER

Principles Based Approach Vs Rules Based Approach to Ethics:

- Ethical guidance may follow principles-based approach or rules-based approach.
- 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. Rules- based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

SA-210 AGREEING THE TERM OF AUDIT ENGAGEMENT

QUESTION-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.

ANSWER

Terms Of Engagement In Recurring Audits

- In case of recurring audits, 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.
- **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:**
 - a) Any indication that the entity misunderstands the objective and scope of the audit.
 - b) Any revised or special terms of the audit engagement.

- c) A recent change of senior management.
 - d) A significant change in ownership.
 - e) A significant change in nature or size of the entity's business.
 - f) A change in legal or regulatory requirements.
 - g) A change in the financial reporting framework adopted in the preparation of the financial statements.
 - h) A change in other reporting requirements.
- In the given case, auditor noticed that there is substantial change in management and also client has ventured into areas of business activity which were not present at time of accepting initial audit engagement.
 - **Conclusion:** -Auditor may decide to send a new audit engagement letter.

QUESTION-2

The management of an entity feels that it is not necessary for it to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework.

Discuss, whether, it is necessary for the management to do so. In case management refuses, why should an auditor not accept the proposed engagement?

ANSWER

Preconditions For An Audit

- It is necessary for management to give in writing to the auditor that it understands its responsibilities for preparation of F.S. in accordance with applicable FRF. It is a necessary precondition for an audit in accordance with SA 210.
- **If preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, auditor shall not accept proposed audit engagement:**
 1. If the auditor has determined that the FRF to be applied in the preparation of the F.S. is unacceptable or
 2. If the agreement of management is not obtained on matters relating to
 - a) understanding of responsibility of management on preparation of financial statements,
 - b) internal controls for preparation of financial statements,
 - c) providing access to all information to auditor and unrestricted access to persons within the entity.
- **Conclusion:** -Unless required by law or regulation to do so, such a refusal on the part of auditor is necessary as management is not willing to accept its responsibility for preparation of F.S. in accordance with applicable FRF.

QUESTION-3

Chirag, as part of articulated training, is part of an engagement team conducting audit of a company. He has read somewhere that engagement letter issued by auditor to client also includes expected form and content of the auditor's report.

He was at a loss to understand how could an auditor include form and content of the report beforehand. Try to help Chirag by making things clear to him.

ANSWER

Form And Content Of Auditor's Report In Engagement Letter

Engagement letter includes reference to expected form and content of audit report. It merely states that auditor would provide opinion in this form. However, engagement letter also includes statement that the form and content of report may

need to be amended in the light of audit findings. Therefore, if in light of audit findings, auditor needs to give a modified opinion, he shall do so.

SQC 1 - QUALITY CONTROL FOR FIRMS THAT PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION, AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

QUESTION-1

CA Arpita has joined a mid-sized CA firm recently. She finds that partners remain too busy and the firm is proposing to accept audit work in areas in which it has no experience or capabilities.

The firm is proposing to accept audit of some entities engaged in emerging "fin-tech" sector. Such audits may be requiring extensive use of technology and data analytics.

However, the said firm has no such capabilities and trained personnel. Discuss, whether, firm should accept such audits with reason.

ANSWER

Acceptance Of Client Relationships And Specific Engagements

- SQC 1 requires that before accepting an engagement, competence (including capabilities, time and resources) to perform engagement have to be considered.
- In the given case, the proposed engagements involve use of technology and data analytics. The firm has no prior experience of audits in emerging "fintech" sector. The firm does not have trained personnel to carry out these audits.
- **Conclusion:** - Offer should not be accepted.

QUESTION-2

How does SQC 1 ensure that independence in engagements is not breached by an audit firm?

ANSWER

Ensuring Independence

- As per SQC 1, firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its 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 EPs 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.

SA 220 -QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS UDIT OF FINANCIAL STATEMENTS

QUESTION-1

CA PK Nair is offered appointment as auditor of a company engaged in providing tourism services. While making due diligence of the proposed client, he comes to know that there have been raids on premises of the company and residences of its directors by National Investigation Agency (NIA) on suspicion of links with terror outfits.

It has been followed up with searches by Enforcement Directorate hunting for illicit money trail. There is a strong suspicion of tourism services provided by company being façade of terror funds. Should proposed offer be accepted by him?

ANSWER

Information To Be Considered Before Accepting An Audit

- Integrity of principal owners has to be considered before accepting an audit engagement in accordance with SA 220. In this regard, SA 220 states requirements on lines of SQC 1.
- SQC 1 clearly states that in cases where there are indications that the client might be involved in money laundering or other criminal activities, appointment should not be accepted.
- . In the instant case, there have been raids of NIA on suspected links with terror outfits which is a criminal activity. Further, raids by Enforcement Directorate also point towards money laundering.

Conclusion: - Proposed offer should not be accepted.

QUESTION-2

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?

ANSWER

Leadership Responsibilities For Quality On Audits

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. Actions of engagement partner and appropriate messages to the other members of the team, in taking responsibility for the overall quality on each audit engagement, emphasise:

- ***The importance to audit quality of:***
 - a) Performing work that complies with professional standards and regulatory and legal requirements;
 - b) Complying with the firm's quality control policies and procedures as applicable;
 - c) Issuing auditor's reports that are appropriate in the circumstances; and
 - d) The engagement team's ability to raise concerns without fear of reprisals; and
- The fact that quality is essential in performing audit engagements.

MCQS BASED QUESTIONS

(1) Identify the most appropriate statement: -

- (a) SA 220 applies at the level of firm.
- (b) SQC 1 is premised on the basis that firm is subject to SA 220.
- (c) SA 220 is premised on the basis that firm is subject to SQC 1.
- (d) SA 220 applies to all engagements.

(2) Professional skepticism includes-

- (a) Overlooking unusual circumstances.
- (b) Using inappropriate assumptions in determining extent of audit procedures.
- (c) Over generalising when drawing conclusions from audit observations.
- (d) Being vigilant to conditions that might indicate possibilities of fraud.

(3) Which of the following is not a fundamental principle governing professional ethics?

- (a) Professional competence and due care
- (b) Integrity
- (c) Objectivity
- (d) Safeguards to independence

(4) Which of the following is not necessary to establish preconditions for an audit?

- (a) Acceptability of financial reporting framework.
- (b) Acknowledgment of cooperation from management in designing audit procedures.
- (c) Acknowledgment from management of providing access to persons within company.
- (d) Acknowledgment of management in understanding its responsibility for preparation of financial statements.

(5) Identify the most appropriate statement in context of SQC 1.

- (a) Assembly of engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements.
- (b) Engagement files should be completed before date of auditor's report in case of audit engagements.
- (c) Engagement files should be completed in not more than 60 days after completion of an engagement.
- (d) Engagement files should be completed on date on which audit report is signed in case of audit engagements.

Answers to the MCQs based Questions

1. c 2. d 3. d 4. b 5. a

TRUE/FALSE QUESTIONS

QUESTION-1

Preconditions for an audit have not been defined in SA 210 "Agreeing the Terms of Audit Engagements."

ANSWER

Statement is Incorrect

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.

QUESTION-2

SA 210 does not require the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.

ANSWER

Statement is Incorrect

SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.

QUESTION-3

It is important for the auditor that each party should be clear about the nature of the engagement.

ANSWER

Statement is Incorrect

It is important, both for the auditor and client, that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work.

QUESTION-4

There is no need to put the nature of engagement to writing.

ANSWER

Statement is Incorrect

As required by SA 210, terms of audit engagement need to be recorded in writing.

It is important, both for the auditor and client, that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work.

QUESTION-5

The Audit Engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor's report or the date of the group auditor's report, whichever is later.

ANSWER

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.

QUESTION-6

An Auditor is considered to lack independence if the partner of the audit firm deals with shares and securities of the audited entity.

ANSWER

Statement is correct.

- As per Sec. 141(3)(d), a person shall not be eligible for appointment as an auditor of a company namely- a person, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. From the above it can be concluded that if the partner deals with shares and securities of the audited entity, he would be lacking independence, hence, disqualified to be appointed as an auditor.

- Further, the Code of Ethics for Professional Accountants, identifies five types of threats and if partner of the firm deals with shares and securities of the audited firm then such threat is known as the Advocacy Threats and auditor will be lacking independence.

QUESTION-7

Engagement partner refers to the partner or other person in the firm who is responsible for the audit engagement.

ANSWER

Statement is Correct.

As per SA 220 "Quality control for an Audit of Financial Statements", 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.

QUESTION-8

The audit engagement letter is sent by the client to auditor.

ANSWER

Statement is incorrect.

As per SA 210 "Agreeing the Terms of Audit Engagements", the Audit engagement letter is sent by the auditor to his client.

QUESTION-9

Confidentiality requires an auditor to be straight forward and honest in all professional and business relationships.

ANSWER

Statement is Incorrect.

Integrity requires an auditor to be straight forward and honest in all professional and business relationships. It implies fair dealing and truthfulness. Confidentiality principle requires an auditor to respect the confidentiality of information acquired as a result of professional or business relationships.

QUESTION-10

Advocacy threat, is the threat which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client.

ANSWER

Statement is incorrect.

- Self-interest threat is the threat which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client.
- Further, Advocacy threat is the threat 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.

QUESTION-11

There is a very thin difference between advocacy threats and intimidation threats to an auditor while performing his duty.

ANSWER

Statement is incorrect.

- Advocacy threat may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised.
- Intimidation threat may occur when a professional accountant may be deterred from acting objectively by threats, actual or perceived.

QUESTION-12

Even if law or regulation prescribes sufficient details of the terms of the audit engagement the auditor should record them in a written agreement.

ANSWER**Statement is incorrect.**

If law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

QUESTION-13

The terms of audit engagement can restrict the scope of an audit.

ANSWER**Statement is incorrect.**

- The scope of an audit of financial statements will be determined by the auditor for having regard to the terms of the engagement, the requirement of relevant legislation and the pronouncements of the Institute.
- The terms of engagement cannot, however, restrict the scope of an audit in relation to matters which are prescribed by legislation or by the pronouncements of the Institute.

QUESTION-14

Familiarity 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.

ANSWER**Statement is incorrect.**

- 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.
- Threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism are known as intimidation threats. 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.

CASE SCENARIO

Das & Co, a firm of auditors, is offered appointment as auditor of a company, a prospective new client. CA Sukanya, one of partners, is dealing with new client. While meeting with officers of the company, she comes to know that Sushant, CFO of the company, was her class mate.

In fact, both of them had started CA together. However, Sushant had left CA mid-way due to repeated failures and tried his luck to pursue MBA (finance) from one of leading institutions.

During initial discussions, it transpires that company is going to launch new services in the field of "weather-forecasting". Such services would be available on web site of company and micro weather information would be available on payment of charges. The company requests audit firm to be visibly associated with their marketing blitz.

Assume that firm choses to accept the offer and writes to previous auditor, Walker & Co., to advise whether there exist any professional reasons for them not to accept the proposed offer. However, Walker & Co. do not reply to the request of Das & Co.

During preliminary discussions, it also became known that the said company has acquired all shares of another company. Under relevant provisions of law, financial statements of both companies needed to be consolidated and audited. Despite this knowledge, Das & Co. failed to advise their client regarding audit of consolidated financial statements.

The company also offers auditors contract for providing IT services pertaining to information system of company.

➤ **Based on above, answer following questions:**

Q.1 Considering discussion about Sukanya and Sushant, which of the following statements seems most appropriate?

- a) The above discussion is irrelevant in context of proposed offer.
- b) The proposed offer should be accepted by firm. The engagement team may be headed by CA Sukanya for better coordination and results.
- c) The proposed offer should be accepted by firm. The engagement team may be headed by a different partner of the firm.
- d) The matter is too trivial to be reported by CA Sukanya to other partners of firm.

Q.2 Keeping in view request of the company to be visibly associated with company's new services, identify which type of threat is being faced by audit firm.

- a) Self-interest threat
- b) Familiarity threat
- c) Self-review threat
- d) Advocacy threat

Q.3 The previous auditors, Walker & Co., have not replied to communication of Das & Co. Which fundamental principle of professional ethics is not followed by them?

- a) Objectivity
- b) Professional behaviour
- c) Professional competence and due care
- d) Integrity

Q.4 Das & Co. have failed to advise the company regarding audit of consolidated financial statements. Which fundamental principle of professional ethics is violated by Das & Co.?

- a) Professional behaviour
- b) Integrity
- c) Objectivity
- d) Professional competence and due care

Q.5 Which of the following statements is most appropriate regarding providing offer of work of IT services by auditors to the company?

- a) Such offer may create a self-review threat.
- b) Such offer may create an advocacy threat.
- c) Such offer does not constitute any threat.
- d) Such offer may create self-review and advocacy threats.

Answer to Case Scenario

1 (c)


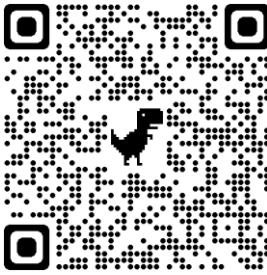


2 (d)

3 (b)

4 (d)

5 (a)

CA NOTES COMMUNITY NETWORK

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